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## User-Friendly Taxpaying

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## User-Friendly Taxpaying

KATHLEEN DELANEY THOMAS\*

*Technology is revolutionizing our lives. With the touch of a button or a simple voice command, we can instantly order groceries, get directions, or find the nearest sushi restaurant. Sensibly, the private sector has capitalized on these recent innovations to drive up profits. To sell more laundry detergent, Amazon now enables consumers to order refills by simply pressing the “dash button” mounted above their laundry machines. Starbucks lures more customers by allowing them to pre-order online and have their drink waiting when they arrive at the store. The theory behind this approach is simple: if you want someone to use your product or service, you should make it as quick and easy as possible for them to do so.*

*This Article makes a novel argument to extend this line of reasoning to encourage better compliance with the tax laws. In making this argument, the Article draws upon behavioral science research showing that complexity impacts individuals’ decision making and encourages dishonesty. The Article then offers a number of proposals for how policy makers could simplify individuals’ interactions with the tax system. For example, the IRS could allow taxpayers to easily record their income and deductions online during the year using smart phones or tablets. Those items could be stored in an online personal taxpayer account and, at the end of the year, automatically uploaded to an electronic return. Easing the burden of taxpaying should encourage more taxpayers to report honestly, in addition to reducing their compliance costs. In the same way that designing products or websites to be user-friendly encourages their use, making the tax system more user-friendly should attract more voluntary participation.*

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**User-friendly** (adjective): *Easy to learn, use, understand, or deal with.*  
Merriam-Webster Dictionary

#### INTRODUCTION

The U.S. tax system relies on voluntary participation.<sup>1</sup> Every year, the government asks taxpayers to honestly report how much income they've earned and pay any taxes that were not previously withheld or otherwise paid. Because the IRS cannot feasibly audit every taxpayer and detect all instances of noncompliance, policy makers try to encourage people to report honestly of their own accord. And while many taxpayers fully comply, the government still comes up short by billions of dollars each year from those who don't.<sup>2</sup> Scholars have argued that we can encourage more voluntary tax compliance by getting to the root cause of why people cheat on their taxes. For example, some have suggested that people intentionally evade because they think the tax system is unfair, because they don't like the way that their tax dollars are being spent, because they believe that everyone else is cheating too, or because they don't think they will get caught.<sup>3</sup> While all of these theories have merit, this Article suggests that there is an additional, less nefarious explanation for why some taxpayers don't pay what they owe: it's too much work. It contends that more taxpayers would willingly report all of their income if doing so weren't so burdensome.

Our income tax system is notoriously complex. The sheer volume of tax statutes and regulations, along with the technical nature of many tax provisions, means that many individuals don't fully comprehend the substance of the tax rules that apply to them. This Article refers to this type of tax complexity as *substantive complexity*. Although many scholars and commentators have argued for reforms that would simplify the substance of our tax laws, others have argued that complexity is necessary if we want to tax each person according to his or her individual circumstances. For example, we use multiple income tax rates instead of a single tax rate so that

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1. Some scholars have described the U.S. tax system as "quasi-voluntary." See, e.g., MARGARET LEVI, OF RULE AND REVENUE 53–54 (1988). The description is apt because income that is reported to the IRS by third parties (like employers or banks) is essentially impossible to hide from the IRS.

2. The vast majority of income subject to third-party withholding and/or information reporting is reported accurately to the IRS. This Article is primarily concerned with income, such as that earned in cash or from self-employment, that is not reported to the IRS by third parties. Less than half of such income is reported accurately, resulting in over \$100 billion of lost tax revenue annually. See INTERNAL REVENUE SERV., TAX GAP FOR TAX YEAR 2006: OVERVIEW tbl.1 (2012), [http://www.irs.gov/pub/newsroom/overview\\_tax\\_gap\\_2006.pdf](http://www.irs.gov/pub/newsroom/overview_tax_gap_2006.pdf) [<https://perma.cc/8ETE-9SV3>].

3. See, e.g., James Andreoni, Brian Erard & Jonathan Feinstein, *Tax Compliance*, 36 J. ECON. LITERATURE 818 (1998); Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 FLA. TAX REV. 599, 614–15 (2007); Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1468–69 (2003); Yair Listokin & David M. Schizer, *I Like To Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System*, 66 TAX L. REV. 179 (2013); Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSP. 25 (2007).

wealthier taxpayers will pay a higher proportionate share of their income than lower-income taxpayers.

But there is another type of complexity embedded in our tax system that has been underexplored in the debate over simplification. Apart from the fact that the substance of our tax laws is confusing, our interactions with the tax system can also be incredibly tedious and burdensome. Even when taxpayers understand the relevant legal rules, complying with one's tax obligations may still entail a complex *process*, such as sifting through pages of forms, reading lengthy instructions, and spending hours entering information on returns. This Article refers to this type of tax complexity as *procedural complexity*. While many taxpayers may be able to avoid the substantive complexity of the tax system by relying on tax return preparers or tax-preparation software to help them determine their tax liability, it is difficult to escape the procedural complexity of the system. Even taxpayers who do not prepare their own tax returns are responsible for managing their tax affairs, for example by keeping records and collecting year-end information statements. Further, nearly half of taxpayers self-prepare their tax returns, resulting in millions of individuals spending billions of collective hours each year dealing with the tax system.

This Article's core argument is that policy makers could improve tax compliance by reducing the procedural complexity of the tax system. The sheer annoyance of the taxpaying process—weeding through forms, schedules, and tables at tax time, or worrying about which information statements contain reportable income and which do not, for example—deters voluntary participation in the system. In many instances, taxpayers may conclude that fully complying with their tax obligations requires too much effort. This tendency towards laziness is supported by numerous behavioral studies.<sup>4</sup>

The human brain is hardwired to conserve mental resources. Empirical research shows that, given alternative courses of action, individuals consistently prefer the one that requires the least amount of mental effort. Studies also show that our brain is like a muscle that is subject to fatigue. When we expend mental effort doing things like making decisions, resisting temptation, or thinking hard during the course of our workday, we exhaust a limited pool of mental energy and become mentally depleted. Mental depletion, in turn, affects our behavior. Studies have shown that people who are mentally exhausted are more likely to cheat, less able to exhibit self-control, and more likely to behave passively.

These behaviors have important implications for tax compliance for two reasons. First, complying with our tax obligations is mentally exhausting, and this is greatly exacerbated by the procedural complexity of the tax system. Second, the types of behaviors demonstrated by individuals who are mentally depleted—passivity, dishonesty, and lack of self-control—are the very behaviors that encourage tax evasion and discourage individuals from voluntarily reporting income. The fact that dealing with our tax obligations is mentally draining means that taxpayers have less mental energy to overcome the temptation to cheat and to report their income accurately. Thus, if the government wants to promote better tax compliance, it should make the *process* of taxpaying easier.

This Article makes several contributions to the existing tax literature. It first

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4. These empirical studies are discussed in detail below in Part II.

explores an aspect of our tax system that has received relatively little attention from legal scholars: procedural complexity. It then applies current behavioral science research to offer an explanation for why procedural complexity may encourage tax evasion. The second half of the Article then offers a number of policy proposals for reducing the procedural complexity of the tax system. I argue that policy makers should draw upon lessons from the private sector, where it is well established that consumers demonstrate a strong preference for simplicity. In the same way that designing products or websites to be user-friendly encourages their use, making the tax system more user-friendly should attract more voluntary participation.

This Article proceeds as follows. Part I explores the complexity of the tax system and situates the Article within the existing literature on tax complexity. It makes a novel contribution to that literature by drawing a distinction between substantive complexity and procedural complexity and argues that procedural complexity contributes to tax evasion. Part II examines empirical studies on mental depletion and its effect on human behavior, while Part III discusses the implications of this research for tax compliance. Part IV then offers a number of proposals to reduce the procedural complexity of the tax system in order to improve voluntary tax compliance and addresses several potential objections to these proposals.

#### I. TAX COMPLEXITY: WHAT IT MEANS AND WHY IT MATTERS

That our current tax system is complex is uncontroversial.<sup>5</sup> Scholarly debate in this area generally has centered on how much complexity is justified and how to best simplify the tax laws. The focus of this commentary has largely been on the substance of the tax laws. After examining the existing tax literature on complexity, this part examines another aspect of tax complexity: the complexity of the *process* of complying with one's tax obligations.

This Part then turns to the relationship between complexity and voluntary tax compliance. Scholars have argued that substantive tax complexity may lead to lower tax compliance, either by causing taxpayers to make unintentional errors or by encouraging outright tax evasion. But procedural tax complexity may also contribute to noncompliance. Because the process of managing one's tax affairs can be so burdensome, taxpayers may be more likely to evade their obligations in order to avoid the associated effort.

##### *A. Complexity in the Tax Literature*

A number of tax scholars have explored the complexity of the U.S. tax system in detail, describing various aspects of the tax laws that are complex and debating the merits of complexity. Before introducing a new framework for thinking about tax complexity, this section briefly overviews the existing tax literature on complexity.

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5. See, e.g., Deborah H. Schenk, *Simplification for Individual Taxpayers: Problems and Proposals*, 45 TAX L. REV. 121, 123 (1989) ("There is no disagreement about the complexity of the Internal Revenue Code.").

## 1. Meaning of Tax “Complexity”

Tax scholars have identified multiple facets of tax complexity. First, the legal rules governing our tax obligations are complex (referred to here as *rule-based complexity*).<sup>6</sup> The Internal Revenue Code itself is complex, as are the Treasury regulations, IRS rulings and other forms of administrative guidance, and judicial interpretations of the tax laws. The sheer volume of these rules makes them complicated. For example, as of June 2000, there were roughly 700 Internal Revenue Code sections applicable to individuals and 20,000 pages of Treasury regulations.<sup>7</sup> Technical or unclear language in statutes or other legal rules also adds complexity.<sup>8</sup> And even the most simply drafted and concise legal rules may still be difficult for taxpayers to comprehend if their substance involves sophisticated concepts.<sup>9</sup> For example, rule-based complexity might make it hard for a taxpayer to determine whether certain expenses are deductible or whether she qualifies as “head of household” for income tax filing purposes.<sup>10</sup>

Another form of rule-based complexity is *computational complexity*, a term coined by Lawrence Zelenak to describe complicated and burdensome calculations such as those involved in computing alternative minimum tax (AMT) liability or phaseouts of certain credits and deductions.<sup>11</sup> For example, although it may be clear to a taxpayer that she is entitled to deduct a “personal exemption” on her tax return, computing the amount of that personal exemption may involve substantial computational complexity because the exemption is gradually phased out as the taxpayer’s income increases.<sup>12</sup>

Closely related to rule-based complexity is what commentators call *structural complexity*.<sup>13</sup> Even if taxpayers understand the tax rules in isolation, structural complexity describes the difficulty taxpayers may have in applying the rules to their own affairs.<sup>14</sup> Take, as an example, a taxpayer who replaces a number of damaged windows in her office building with new windows. Although she may understand that the tax law allows the cost of building “repairs” to be immediately deducted while the cost of building “improvements” must be capitalized (i.e., not currently

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6. DAVID F. BRADFORD, UNTANGLING THE INCOME TAX 266–67 (1986). Edward McCaffery describes this as “technical complexity,” which is the “pure intellectual difficulty of ascertaining the meaning of tax law.” Edward J. McCaffery, *The Holy Grail of Tax Simplification*, 1990 WIS. L. REV. 1267, 1270–71.

7. 1 STAFF OF THE J. COMM. ON TAXATION, 107TH CONG., JCS-3-01, STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986, at 4 (Comm. Print. 2001) [hereinafter JCT REPORT].

8. *Id.* at 5.

9. *See id.* at 101.

10. *See* I.R.C. § 2(b).

11. LAWRENCE ZELENAK, LEARNING TO LOVE FORM 1040: TWO CHEERS FOR THE RETURN-BASED MASS INCOME TAX 113 (2013).

12. *See* I.R.C. § 151(d)(3) (West Supp. 2016).

13. McCaffery, *supra* note 6, at 1271; *see also* BRADFORD, *supra* note 6, at 267 (“transactional complexity”).

14. McCaffery, *supra* note 6, at 1271.

deducted), she may not be certain whether the new windows constitute a repair or an improvement.<sup>15</sup>

Finally, *compliance complexity* describes the difficulty taxpayers may face in understanding and complying with various filing and recordkeeping requirements.<sup>16</sup> A taxpayer may, for example, know that he is eligible to receive the earned income tax credit but not understand which tax form(s) he must file to claim the credit.<sup>17</sup>

## 2. Weighing the Merits of Tax Complexity

Although there is consensus among scholars that our current tax rules are complex, there is some disagreement over whether such complexity is problematic, inevitable, or even desirable.<sup>18</sup> Many commentators view complexity as a necessary component of an income tax that seeks to promote equity, encourage certain behavior, and correct for market externalities in the most efficient manner possible.<sup>19</sup> For example, some sources of complexity in the tax law—such as personal deductions, credits, and exemptions—are a necessary byproduct of taking each individual's personal circumstances into account when calculating tax liability.<sup>20</sup> Other commentators see our system as broken and in dire need of simplification.<sup>21</sup> This debate largely centers on the substance of the tax laws themselves, a problem that generally must be remedied by congressional action.<sup>22</sup> Many, for example, have urged legislators to

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15. See I.R.C. § 263(a)(1) (West Supp. 2016); Treas. Reg. § 1.162-4 (as amended in 2014); Treas. Reg. § 1.263(a)-3(k)(7) ex. 25–26 (replacing 100 out of 300 windows not a capitalizable improvement, but replacing 200 out of 300 windows treated as a restoration of the building's structure and therefore an improvement).

16. BRADFORD, *supra* note 6, at 266–67; McCaffery, *supra* note 6, at 1272; Schenk, *supra* note 5, at 166.

17. In addition to describing categories of tax complexity, scholars have also identified a number of *sources* of tax complexity, including the proliferation of tax expenditures and the use of “income” as a tax base. See, e.g., JCT REPORT, *supra* note 7, at 5; MICHAEL BROSTEK, U.S. GOV'T ACCOUNTABILITY OFF., GAO-11-747T, TAX GAP: COMPLEXITY AND TAXPAYER COMPLIANCE 11 (2011); ZELENAK, *supra* note 11, at 114; Samuel A. Donaldson, *The Easy Case Against Tax Simplification*, 22 VA. TAX REV. 645, 654–69 (2003); Louis Kaplow, *How Tax Complexity and Enforcement Affect the Equity and Efficiency of the Income Tax*, 49 NAT'L TAX J. 135, 138–39 (1996); McCaffery, *supra* note 6, at 1273–74.

18. See Donaldson, *supra* note 17, at 652; McCaffery, *supra* note 6, at 1267; Schenk, *supra* note 5, at 123.

19. Donaldson, *supra* note 17; McCaffery, *supra* note 6, at 1318–22 (discussing pros and cons of simplification).

20. JOEL SLEMROD & JON BAKIJA, *TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES* 167 (4th ed. 2008); McCaffery, *supra* note 6, at 1281.

21. See, e.g., 1 NINA E. OLSON, *TAXPAYER ADVOCATE SERV., 2012 ANNUAL REPORT TO CONGRESS* 3 (2012) (“The most serious problem facing taxpayers—and the IRS—is the complexity of the Internal Revenue Code . . .”).

22. See, e.g., BROSTEK, *supra* note 17 (recommending Congress simplify the tax code, and IRS and Congress together enhance third-party information reporting and compliance checks); OLSON, *supra* note 21 (urging Congress to simplify Code). See generally Schenk, *supra* note 5 (offering legislative proposals to simplify tax rules).



repeal tax expenditures to simplify the code,<sup>23</sup> while others have suggested that a move to a flat tax or a consumption tax would be the best way to simplify.<sup>24</sup> Although both sides make compelling arguments, it is not necessary to resolve the debate over whether we should implement fundamental changes to our tax base or rate structure here. The tax legislative process is subject to gridlock<sup>25</sup> and mired in politics, and this Article seeks to explore simplification alternatives that would not require fundamental changes to our tax code. But before turning to those proposals, the next part introduces a new framework for thinking about tax complexity.

### *B. A New Framework: Procedural Versus Substantive Complexity*

This Article focuses on the difficulty of the *process* of paying taxes. Accordingly, it draws a distinction between complexity in the substance of the tax rules versus complexity in the procedures related to managing our tax affairs. Concededly, these two types of complexity may sometimes be inextricably linked to one another, and the boundary between them may not always be clear. But the benefit of focusing on this distinction is that it offers an additional perspective on tax evasion: While past tax scholarship has argued that there is a link between substantive tax complexity and evasion, this Article asserts that procedural tax complexity also likely plays an important role in tax noncompliance.

#### 1. Substantive Complexity

It is clear that some aspects of our tax system cause taxpayers to experience confusion and uncertainty. This confusion can result from any of the types of complexity described above. Taxpayers may find it difficult to understand the meaning of statutes, regulations, or rulings (rule-based complexity). Or they may have trouble understanding how to apply those rules to their own situation (structural complexity). And taxpayers may not understand which forms, records, or other steps are needed to comply (compliance complexity). The common thread here is that the complexity in the tax rules makes it difficult for taxpayers to comprehend those rules. I refer to this type of complexity as *substantive complexity*.

Substantive complexity encompasses more than just rule-based complexity. The “substance” here could be the substance of a tax statute, or it could simply be the substance of an instruction to a tax form. Substantive tax complexity refers to any complexity that causes taxpayers to not understand what is asked of them, or at the very least causes uncertainty. It does not matter what stage of the process the taxpayer is in (e.g., reading a statute, applying a rule, or filling out a form). Any of the types of complexity traditionally described in the literature could potentially result in substantive complexity.

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23. See, e.g., OLSON, *supra* note 21, at 3, 15; SLEMROD & BAKIJA, *supra* note 20, at 216–17.

24. See, e.g., MICHAEL GRAETZ, 100 MILLION UNNECESSARY RETURNS (2008) (proposing a flat VAT for most people); SLEMROD & BAKIJA, *supra* note 20, at 194 (discussing simplicity of a single rate on income); *id.* at 216 (discussing simplicity of a consumption base).

25. See Jason S. Oh, *The Pivotal Politics of Temporary Legislation*, 100 IOWA L. REV. 1055, 1063–66 (2015).

## 2. Procedural Complexity

Substantive complexity can be contrasted with “procedural complexity.” Procedural complexity refers to any type of complexity that involves burdensome or numerous processes or steps. Whereas the key to substantive complexity is confusion and uncertainty, the key to procedural complexity is taxpayer *burden*. A taxpayer faces procedural complexity, for example, when she understands the substance of a rule allowing her to claim a particular credit but has to undergo a time-consuming, multistep process to claim the credit.<sup>26</sup> Although procedural complexity is closely related to compliance complexity, the two are distinct. The compliance complexity described in the literature generally encompasses any form of complexity that is related to the recordkeeping and filing obligations of taxpayers. Compliance complexity could be substantive (e.g., a taxpayer does not understand the rules governing which records she must keep) or procedural (e.g., a taxpayer understands the recordkeeping requirements, but they are burdensome and time-consuming).

## 3. Evaluating Tax Rules Under the Substantive/Procedural Framework

Using this framework, we can evaluate the complexity of any aspect of the tax system on two dimensions: whether the substantive complexity is high or low and whether the procedural complexity is high or low.<sup>27</sup> For example, some tax rules are high in both substantive and procedural complexity, like the notoriously complicated AMT. The substance of the relevant code sections<sup>28</sup> is hard to understand without tax expertise, and it can also be incredibly difficult for taxpayers to predict whether it will apply to them. Even if they know they will be subject to the AMT, many taxpayers likely do not understand, substantively, how or why their tax bill is higher.<sup>29</sup> The AMT is high in procedural complexity, as well. Calculation of one’s AMT liability without the help of software requires filling out a sixty-line form with fourteen pages of instructions and multiple worksheets,<sup>30</sup> which is a burdensome process even for those who are able to fully comprehend the steps. And even taxpayers using tax-preparation software might be subject to procedural complexity related to the AMT because software packages may require certain calculations to be done by hand.

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26. Leandra Lederman and Stephen W. Mazza use the term “procedural complexity” in *Addressing Imperfections in the Tax System: Procedural or Substantive Reform?*, 103 MICH. L. REV. 1423, 1438–44 (2005) (book review). However, their focus is primarily on the complexity of various tax procedure rules, such as those surrounding collection due process hearings, and the impact that such complexity has on the IRS’s ability to effectively administer the tax laws. *Id.*

27. The “high” versus “low” distinction is a simplification (no pun intended). Whether a provision is simple or complex on either dimension would fall onto a spectrum, where some provisions are more complex than others.

28. I.R.C. §§ 55–59 (West Supp. 2016).

29. ZELENAK, *supra* note 11, at 113–14.

30. See INTERNAL REVENUE SERV., DEP’T OF TREAS., FORM 6251, ALTERNATIVE MINIMUM TAX—INDIVIDUALS (2016), <http://www.irs.gov/pub/irs-pdf/f6251.pdf> [<https://perma.cc/TY8J-WS5M>]; INTERNAL REVENUE SERV., DEP’T OF TREAS., INSTRUCTIONS FOR FORM 6251 (2016), <https://www.irs.gov/pub/irs-pdf/i6251.pdf> [<https://perma.cc/ZRG2-4ELP>].

Other tax provisions may be high in substantive complexity but low in procedural complexity. Consider, for example, a self-employed taxpayer who owns a building related to her business with multiple air conditioning units. Further assume that when two of the units break down, she replaces them with new units that are ten percent more energy efficient. The rules governing whether she may deduct that expense or must capitalize it are substantively complex. Generally, “repairs” are deductible but “improvements” are not. In this case, the units had to be replaced because they were broken, but they have been replaced with an improved model. The regulations under § 263(a) of the Internal Revenue Code provide a complicated framework of rules for determining what constitutes an improvement for this purpose (in this case, the cost is deductible),<sup>31</sup> making this relatively high in substantive complexity. However, the procedural complexity is low. For a taxpayer that is able to determine that the replacement cost is a deductible business expense, she may simply report that expense in full on line 21 (“Repairs and maintenance”) of Schedule C.<sup>32</sup>

Other rules may be high in procedural complexity but low in substantive complexity. Consider, for example, a taxpayer who owns a taxable investment account consisting of stocks and bonds that is managed by a financial institution. Assume that, during the tax year, the account generated capital gains and losses from sales of stocks. The financial institution will issue the taxpayer an information statement<sup>33</sup> (Form 1099-B) at year-end to show the gain and loss from those sales. To report the gain or loss, the taxpayer must fill out Form 8949. Rather than simply reporting net amounts of long-term or short-term capital gain or loss, the taxpayer must enter the following information for each transaction:<sup>34</sup>

- Description of property sold
- Date acquired
- Date sold
- Cost basis (generally the purchase price)
- Sale proceeds
- Net gain or loss

For taxpayers with a high volume of sales transactions, this can be a tedious and time-consuming process, and the use of tax-preparation software may not ease the burden. However, the process itself is fairly straightforward and intellectually simple. And the substance of the applicable legal rules—that the net gain or loss (generally the difference between the purchase price and the sale price) must be reported for tax purposes<sup>35</sup>—is also relatively simple. The result is low substantive complexity with relatively high procedural complexity.

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31. See Treas. Reg. § 1.263(a)-3(i)(6) ex. 20 (as amended in 2014).

32. INTERNAL REVENUE SERV., DEP’T OF TREAS., SCH. C (FORM 1040), PROFIT OR LOSS FROM BUSINESS 1 (2016), <http://www.irs.gov/pub/irs-pdf/f1040sc.pdf> [<https://perma.cc/TE52-47MP>].

33. See I.R.C. § 6045(a) (West Supp. 2016).

34. INTERNAL REVENUE SERV., DEP’T OF TREAS., FORM 8949 (2016), <http://www.irs.gov/pub/irs-pdf/f8949.pdf> [<https://perma.cc/6Q8V-JXRD>].

35. See generally I.R.C. §§ 1001(a)–(b), 1012 (West 2011 & Supp. 2016). The taxpayer’s basis in the property sold may be subject to other adjustments not relevant for purposes of this example. See I.R.C. § 1011(a) (2012).

Finally, some rules are low in both substantive and procedural complexity. An example is reporting wage income, which is reported to taxpayers on Form W-2. The substance of these rules is simple. Your wages are taxable income,<sup>36</sup> and they must be reported on line seven of Form 1040 (“Wages, salaries, tips, etc.”). The procedure is also simple. The taxpayer must simply enter the amount of wages reported on Form W-2 on her tax return and attach the W-2<sup>37</sup> or enter her W-2 information into a software program.

The relationship between substantive and procedural complexity is summarized with examples in the table below:

	High Procedural Complexity	Low Procedural Complexity
High Substantive Complexity	Calculating and Reporting AMT	Reporting a Single Deductible “Repair” Expense
Low Substantive Complexity	Reporting Sales of Investments (Broker Transactions)	Reporting Wage Income

The policy proposals in the latter half of this Article focus on ways to reduce procedural complexity in an effort to improve tax compliance. The ripest fruit here is rules that are high in procedural complexity and low in substantive complexity. Some procedurally complex rules directly correlate to substantive complexity in the underlying statute, and it may be hard to reduce one without the other. For example, the complicated rules under the AMT require many calculations that are bound to be burdensome. Eliminating or simplifying the AMT itself (reducing substantive complexity) seems to be the more natural fix. But burdensome reporting rules relating to relatively simple substantive concepts (e.g., broker transactions) may be better targets for reforming the process under which we pay taxes.

Reducing procedural complexity in the tax system has the potential to produce enormous social gains because it would cut down on the time and resources that taxpayers spend complying with the tax laws. But an important second-order effect of this reduction in taxpayer effort is its potential impact on taxpayer compliance. Procedurally complex rules are mentally exhausting to deal with, and some taxpayers may fail to comply because they think doing so is too much work. The next section more fully explores the relationship between complexity and tax compliance.

### *C. Impact of Complexity on Taxpayer Compliance*

A number of commentators have focused on the negative impact that tax complexity may have on voluntary tax compliance; however, this literature is generally focused on substantive complexity.<sup>38</sup> Scholars’ arguments generally offer three

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36. See I.R.C. § 61 (2012).

37. See INTERNAL REVENUE SERV., DEP’T OF TREAS., FORM 1040, U.S. INDIVIDUAL TAX RETURN (2016) [hereinafter FORM 1040].

38. One exception is MARK PHILLIPS & ALAN PLUMLEY, EFFORT AND COMPLIANCE AS

explanations for why complexity causes lower compliance: unintentional errors; increased opportunities for avoidance or evasion; and evasion due to resentment or perceived unfairness.

### 1. Noncompliance Due to Substantive Complexity

First, a number of commentators have argued that complexity in the tax law will inevitably cause taxpayers to make mistakes.<sup>39</sup> If taxpayers don't understand the rules that govern their tax liability, it is possible they will accidentally underreport that liability. However, the net effect here is unclear, as taxpayers may unintentionally overreport their tax liability, as well. Additionally, some taxpayers may take intentionally conservative tax positions (again, potentially overreporting) in the case of uncertainty because they fear the repercussions if they underreport.<sup>40</sup>

Second, commentators have argued that the uncertainty created by complex laws creates opportunities for and may encourage intentional tax evasion.<sup>41</sup> Complex laws may be more difficult for the IRS to enforce and may consume more government resources. Thus, taxpayers may be more inclined to play the "audit lottery" and assume that they are unlikely to get caught cheating.<sup>42</sup> Complicated rules may also lead taxpayers to believe they will have more success defending their position if they are caught underreporting because they can claim (whether honestly or not) to not understand the relevant rules. Other taxpayers may stop short of outright evasion but take aggressive tax positions that are made possible by rules subject to multiple interpretations.

Third, some have argued that complexity lowers taxpayer morale and fosters cynicism.<sup>43</sup> Under this view, taxpayers may be less likely to comply with their tax obligations because they resent the complexity of the tax laws.<sup>44</sup> Or taxpayers may

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ENDOGENOUS TAXPAYER DECISIONS (2014), <https://www.ntanet.org/wp-content/uploads/proceedings/2014/141-phillips-plumley-effort-compliance-endogenous-taxpayer-decisions.pdf> [<https://perma.cc/YM6A-HCFE>]. See also Frank H. Pedersen, *Advancing the Study of Tax Complexity with the Usability Model*, 12 Hous. Bus. & Tax L.J. 282, 287 (2012) (arguing that our understanding of tax complexity should include "taxpayers' empirical experiences in handling their tax affairs").

39. JCT REPORT, *supra* note 7, at 102; BROSTEK, *supra* note 17, at 8; OLSON, *supra* note 21, at 3; Wojciech Kopczuk, *Tax Simplification and Tax Compliance: An Economic Perspective*, in BRIDGING THE TAX GAP 111, 124–25 (Max B. Sawicky ed., 2005). Taxpayers who make unintentional mistakes are also less likely to be deterred by tax penalties, which further undermines the IRS's enforcement efforts. *Id.* at 125.

40. JCT REPORT, *supra* note 7, at 102.

41. See e.g., BROSTEK, *supra* note 17, at 8, 13–14; OLSON, *supra* note 21, at 3.

42. JCT REPORT, *supra* note 7, at 102; McCaffery, *supra* note 6, at 1289–90. The audit lottery is a good bet for some taxpayers (those whose income is not reported by third parties), as the overall audit rate for individuals is currently less than one percent. See INTERNAL REVENUE SERV., FISCAL YEAR 2015 ENFORCEMENT AND SERVICE RESULTS 2 (2015), <https://www.irs.gov/pub/newsroom/fy2015enforcementandserviceresults2015.pdf> [<https://perma.cc/T6T3-5TEM>] (individual audit rate for 2015 was 0.84%).

43. JCT REPORT, *supra* note 7, at 109; OLSON, *supra* note 21, at 3; McCaffery, *supra* note 6, at 1311–12.

44. See McCaffery, *supra* note 6, at 1290.

view a complicated tax system as unfairly favoring some taxpayers over others, which may lead to intentional noncompliance.<sup>45</sup> While there are some studies supporting the assertion that taxpayers think the tax rules are complicated and difficult to apply,<sup>46</sup> some commentators have pointed out that there is no empirical proof that low morale resulting from the complexity of the tax laws actually drives people to intentionally evade their tax liability.<sup>47</sup> Indeed, data on whether taxpayers view the complexity of the tax code as a major problem or as a barrier to compliance is mixed.<sup>48</sup> Scholars have pointed to the fact that overall compliance rates have not changed over time as tax rules have become more complicated, indicating that substantive complexity does not affect voluntary compliance in any significant way.<sup>49</sup>

## 2. Noncompliance Due to Procedural Complexity

As discussed above, scholars have argued that substantive complexity may lead to accidental errors by honest taxpayers or intentional noncompliance by dishonest taxpayers. But there is another reason people might fail to report and pay the tax they owe—something beyond pure accident but far less nefarious than intentional exploitation of the system or outright refusal to pay due to resentment. Some taxpayers simply may be too lazy to comply. They may want to be honest in theory. That is, they don't have an emotional justification to purposefully withhold tax and they don't otherwise plan to cheat because they know they won't get caught. Rather, this Article hypothesizes that there is some not-insignificant group of taxpayers who would report and pay what they owe if the process for doing so required less effort.

Why would effort impact the decision to cheat? As will be discussed in the next Part, empirical evidence has shown that when we deplete our mental resources through an abundance of information, choices, or other activities requiring mental effort, our behavior changes. Mental exhaustion has been linked to dishonesty, lack of self-control, and passivity, all of which may lead to noncompliance with the tax laws. This theory will be developed more fully in Part III.

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45. JCT REPORT, *supra* note 7, at 109. *But see* Adam Forest & Steven M. Sheffrin, *Complexity and Compliance: An Empirical Investigation*, 55 NAT'L TAX J. 75 (2002) (finding in survey data a link between perceived unfairness and lower compliance but no link between perceived complexity of the tax system and perceived unfairness).

46. *See, e.g.*, Tom Beers, Eric LoPresti & Eric San Juan, *Factors Influencing Voluntary Compliance by Sole Proprietors: Preliminary Survey Results* (reporting that fifty-six percent of sole proprietors surveyed agreed that "the tax rules are so complicated [that] it is very difficult to get a tax return exactly right"), in *TAX ADMINISTRATION AT THE CENTENNIAL: AN IRS-TPC RESEARCH CONFERENCE* 65, 81 (Alan Plumley, ed. 2013).

47. *See, e.g.*, Donaldson, *supra* note 17, at 694.

48. *See, e.g.*, TAXPAYER COMPLIANCE, VOLUME 1: AN AGENDA FOR RESEARCH 128 (Jeffrey A. Roth, John T. Scholz & Ann Dryden Witte eds., 1989) ("[R]espondents in several surveys did not list complexity among the major problems with the tax system." (citation omitted)); Beers et al., *supra* note 46, at 81 (finding that most respondents agreed that the rules about what to report as income are clear and that their recordkeeping system made it easy to compute their income); Valerie C. Milliron, *A Behavioral Study of the Meaning and Influence of Tax Complexity*, 23 J. ACCT. RES. 794, 795 (1985).

49. Donaldson, *supra* note 17, at 694.

Procedural complexity may contribute to lower tax compliance in other ways, as well. Like substantive complexity, procedural complexity may lead to unintentional errors that ultimately reduce revenue. Further, it's likely that procedural complexity reduces taxpayer morale, which could result in lower overall compliance. And because the procedural complexity of the tax system is harder to avoid or ignore, it might be a more significant source of taxpayer resentment than substantive complexity. This is consistent with empirical data showing that more than half of taxpayers (55%) rank paperwork and hassle among the top reasons they dislike doing their taxes, as compared to not liking how the government uses their money (12%) or thinking they pay too much tax (5%).<sup>50</sup>

## II. EMPIRICAL RESEARCH: HOW COMPLEXITY IMPACTS BEHAVIOR

Procedural complexity in our tax system means that managing one's tax affairs is often burdensome and time-consuming even when the rules are relatively straightforward. This has important implications for tax compliance because studies show that mental exhaustion leads to certain behavioral tendencies, such as dishonesty or lack of self-control. This part discusses the empirical research on mental fatigue and our natural tendency to avoid mental effort.

### A. *Inherent Laziness and Mental Depletion*

The human brain is fundamentally lazy; we don't like having to think too hard. Mental laziness, as described by the prominent psychologist Daniel Kahneman, "is built deep into our nature."<sup>51</sup> From an evolutionary perspective, this makes sense. Thinking hard causes us to consume glucose, which would have required our ancestors to search for food and expose themselves to predators.<sup>52</sup> Preserving our cognitive resources was simply another form of self-preservation.

A number of psychologists and economists have discussed the implications of our mental laziness on human behavior. One intuitive phenomenon is the "law of least mental effort," which says that if there are multiple ways of achieving a goal, we tend to choose the least demanding course of action.<sup>53</sup> When dealing with cognitive effort, this may result in people relying on intuitions or mental heuristics<sup>54</sup> instead of

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50. See PEW RESEARCH CTR., A THIRD OF AMERICANS SAY THEY LIKE DOING THEIR INCOME TAXES 7 (2013), <http://www.people-press.org/files/legacy-pdf/04-11-13%20Taxes%20Release.pdf> [<https://perma.cc/93CG-32LF>]. The top reasons were "Taxes are complicated/too much paperwork/afraid of mistakes/not good with numbers" (31%) and "Inconvenient/hassle/time consuming" (24%). *Id.* at 7. Although the study indicates taxpayers have negative attitudes about procedural complexity, further study is needed to determine how these attitudes impact voluntary compliance.

51. DANIEL KAHNEMAN, THINKING, FAST AND SLOW 35 (2011); see also SUSAN M. WEINSCHENK, HOW TO GET PEOPLE TO DO STUFF 125 (2013).

52. WEINSCHENK, *supra* note 51, at 125–26.

53. See e.g., Wouter Kool, Joseph T. McGuire, Zev B. Rosen & Matthew M. Botvinick, *Decision Making and the Avoidance of Cognitive Demand*, 139 J. EXPERIMENTAL PSYCHOL. 665, 666 (2010), accord KAHNEMAN, *supra* note 51, at 35.

54. See generally Anuj K. Shah & Daniel M. Oppenheimer, *Heuristics Made Easy: An*

information gathering or calculations when the latter would require more effort.

Psychologists have also theorized that we have a pool of internal resources that we draw upon to perform various cognitive tasks, and that pool is limited and subject to depletion.<sup>55</sup> We use these mental resources to do things like override our impulses, make choices between alternatives, and initiate actions (as opposed to being passive).<sup>56</sup> The resource “resembles an energy or strength,” such that when we dip into it in order to perform some cognitive task, we use up the reserves and become fatigued.<sup>57</sup> Once we have exhausted our mental resources we are in a state of depletion, which has a number of behavioral implications. For example, studies have shown mental depletion can lead to overspending and impulsive purchasing, deviating from one’s diet, aggressive behavior, performing poorly on cognitive tasks,<sup>58</sup> and giving up sooner on frustrating tasks.<sup>59</sup> Some of the relevant research on the effects of mental depletion is discussed in more detail below.

Like our inherent laziness, mental depletion also appears to be biological. Research has shown that our bodies consume glucose when we expend mental energy similar to the way we consume glucose stored in our muscles when we exercise.<sup>60</sup> Thus, when people are mentally fatigued, they have been found to experience a drop in blood glucose levels.<sup>61</sup>

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*Effort-Reduction Framework*, 134 PSYCHOL. BULL. 207 (2008).

55. Roy F. Baumeister, Mark Muraven, and Dianne M. Tice, *Ego Depletion: A Resource Model of Volition, Self-Regulation, and Controlled Processing*, 18 SOC. COGNITION 130, 130–31 (2000).

56. *Id.* at 131.

57. *Id.* Psychologists have termed this phenomenon “ego depletion.” *Id.*

58. KAHNEMAN, *supra* note 51, at 42.

59. For example, in one study, subjects were made to resist temptation by sitting at a table with cookies and radishes and being told to only eat the radishes. Other subjects were told to eat the cookies. Both groups were then asked to complete a set of puzzles that (unbeknownst to the subjects) were unsolvable. The act of resisting temptation to eat the cookies appeared to deplete the subjects who were made to eat radishes. Those subjects gave up on the problem-solving task sooner, whereas the subjects who ate cookies persisted significantly longer. Roy F. Baumeister, Ellen Bratslavsky, Mark Muraven & Dianne M. Tice, *Ego Depletion: Is the Active Self a Limited Resource?*, 74 J. PERSONALITY & SOC. PSYCHOL. 1252, 1253–56 (1998). Having to choose among alternatives also appears to deplete mental energy. Subjects in a similar study who had to make an informed choice before performing a task showed less persistence on the unsolvable puzzles task compared to subjects who were assigned a task and not told to choose among alternatives. *Id.* at 1256–58.

60. KAHNEMAN, *supra* note 51, at 43; Matthew T. Gailliot & Roy F. Baumeister, *The Physiology of Willpower: Linking Blood Glucose to Self-Control*, 11 PERSONALITY & SOC. PSYCHOL. REV. 303, 304, 306 (2007). “[E]ffortful, controlled, or executive processes” require more glucose than “less effortful, or automatic” mental activities. *Id.* at 306.

61. See, e.g., KAHNEMAN, *supra* note 51, at 43; Gailliot & Baumeister, *supra* note 60, at 308–309. For example, subjects who watched a video that required them to “control their attention” by ignoring certain stimuli that flashed across the screen experienced a drop in blood glucose after watching the video. *Id.* at 308. Blood glucose levels did not change for subjects who watched the video without being asked to ignore the stimuli. *Id.* Interestingly, research has also shown that mental depletion can be at least partly undone by ingesting glucose. Rest and sleep have also been found to restore our mental resources after depletion. KAHNEMAN, *supra* note 51, at 43; Gailliot & Baumeister, *supra* note 60, at 309, 318.



*B. The Effect of Mental Depletion on Behavior*

## 1. Passivity

One effect of mental depletion is that it tends to make people behave more passively.<sup>62</sup> For example, a study of Israeli judges found that they were significantly more likely to depart from the status quo by granting parole at the beginning of the day and right after food breaks.<sup>63</sup> On the other hand, they adhered to the status quo and denied parole significantly more after they had spent several hours hearing requests. The authors of the study concluded that the decision making of the judges depleted their mental energy throughout the day, resulting in a clear decline in their willingness to grant parole.<sup>64</sup> Similarly, a field study of car consumers revealed that they are more willing to accept manufacturer default choices if those choices are presented to them later in a series of decisions versus earlier.<sup>65</sup>

## 2. Lower Self-Control

Studies also indicate that mental depletion makes it harder for us to exercise self-control.<sup>66</sup> The theory here is that exercising self-control requires us to override our desires to some extent, by substituting behaviors we want for different (presumably better) behaviors.<sup>67</sup> Like many other cognitive tasks, this requires mental energy on our part.<sup>68</sup> If our reserves of mental energy have been depleted by some other

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62. Baumeister et al., *supra* note 55, at 139.

63. Shai Danziger, Jonathan Levav & Liora Avnaim-Pesso, *Extraneous Factors in Judicial Decisions*, 108 PROC. NAT'L ACAD. SCI. 6889, 6890–6892 (2011).

64. In the morning and right after food breaks, the judges granted approximately sixty-five percent of requests. That number dropped to nearly zero towards the end of a block of time during which requests were heard. *Id.*

65. Jonathan Levav, Mark Heitmann, Andreas Herrmann & Sheen S. Iyengar, *Order in Product Customization Decisions: Evidence from Field Experiments*, 118 J. POL. ECON. 274, 278 (2010).

66. However, it should be noted that, although a number of studies have found that self-control is influenced by mental depletion, a recent replication project failed to find any meaningful effect on self-control. That project did not attempt to replicate studies that showed an effect on honesty or passivity. Martin S. Hagger & Nikos L.D. Chatzisarantis, *A Multilab Preregistered Replication of the Ego-Depletion Effect*, 11 PERSP. ON PSYCHOL. SCI. 546 (2016).

67. See Kathleen D. Vohs, Roy F. Baumeister, Brandon J. Schmeichel, Jean M. Twenge, Noelle M. Nelson & Dianne M. Tice, *Making Choices Impairs Subsequent Self-Control: A Limited-Resource Account of Decision Making, Self-Regulation, and Active Initiative*, 94 J. PERSONALITY & SOC. PSYCHOL. 883, 884 (2008); see also Francesca Gino, Maurice E. Schweitzer, Nicole L. Mead & Dan Ariely, *Unable To Resist Temptation: How Self-Control Depletion Promotes Unethical Behavior*, 115 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 191, 192 (2011) (“Self-control is ‘the ability to override or change one’s inner response, as well as to interrupt undesired behavioral tendencies (such as impulses) and refrain from acting on them.’” (citation omitted)).

68. See Gino et al., *supra* note 67, at 192.

cognitive task, we are less likely to demonstrate self-control.<sup>69</sup>

In one series of experiments, researchers depleted subjects by requiring them to make choices among things like consumer products or college courses from a course catalogue (depletion condition).<sup>70</sup> Other subjects were presented with information but not asked to make choices (no depletion condition). Both groups were then exposed to a scenario that tested self-control. For example, one experiment examined how much subjects would procrastinate during time they were given to study for a math test.<sup>71</sup> The subjects were given a packet of practice problems but were also allowed to read magazines or play a video game during the preparation time.<sup>72</sup> The subjects who had been mentally depleted before the test preparation spent less time studying and more time reading magazines and playing games, indicative of lower self-control.<sup>73</sup> Depleted subjects in other studies similarly tolerated pain less (measured by time spent immersing hands in cold water)<sup>74</sup> and persisted for less time on both solvable and unsolvable puzzles.<sup>75</sup>

### 3. Dishonesty

Finally,<sup>76</sup> researchers have found that people who have been mentally depleted tend to be less honest and are more likely to cheat. For example, in one study, participants were asked to write a short essay without using words that contained the letters A or N (depletion condition) while another group was asked not to use words that contained X or Z (no-depletion condition).<sup>77</sup> Afterwards, both groups were given a problem-solving task for which they would be paid for each correct answer.<sup>78</sup> The subjects had the opportunity to cheat because they graded their own work, self-reported the number of problems that they correctly solved, and paid themselves.<sup>79</sup> As predicted, the depleted participants claimed to have solved significantly more

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69. *See id.*

70. *See* Vohs et al., *supra* note 67, at 885, 887. The choices varied by study.

71. *Id.* at 887. The subjects were told the math test was a predictor of successful life outcomes.

72. *Id.*

73. *Id.* at 888.

74. *Id.* at 887.

75. *Id.* at 890.

76. This discussion highlights some behavioral implications of mental depletion but is by no means exhaustive. There are dozens of studies showing other effects. For an overview of the literature, see Baumeister et al., *supra* note 55.

77. Nicole L. Mead, Roy F. Baumeister, Francesca Gino, Maurice E. Schweitzer & Dan Ariely, *Too Tired To Tell the Truth: Self-Control Resource Depletion and Dishonesty*, 45 J. EXPERIMENTAL SOC. PSYCHOL. 594, 594–595 (2009). Because significantly fewer words contain X and Z, the latter task was not mentally taxing.

78. *Id.* at 594.

79. The researchers gauged dishonesty in this experiment by requiring another group of subjects to have their answers checked by an experimenter. The higher average number of problems claimed to have been solved by those with an opportunity to cheat (the self-scorers) compared to those who had their answers checked was assumed to be the result of dishonesty. Nondepleted subjects who self-scored reported twenty-five percent more correct answers than those who had their answers checked, while depleted subjects who self-scored reported 104% more correct answers than those who had their answers checked. *Id.*

problems than the nondepleted participants, indicating that the former group cheated more. Interestingly, however, depletion did not appear to alter actual performance on the problem-solving task.<sup>80</sup>

A similar experiment depleted participants by instructing them to not look at words flashing across the screen during a video, while the nondepleted participants were given no instructions.<sup>81</sup> Both groups were then asked to solve puzzles for financial compensation and self-report their scores.<sup>82</sup> Again, the depleted participants were more likely to overstate their performance than their nondepleted counterparts, with thirty-four percent cheating in the depleted condition compared to 13.7% in the nondepleted condition.<sup>83</sup> Thus, the authors concluded, “when self-regulatory resources are depleted by prior exertion of self-control, unethical behavior increases.”<sup>84</sup>

### III. IMPLICATIONS FOR TAX COMPLIANCE

The studies discussed above have important implications for tax compliance. The procedural complexity of our tax system may lead to mental depletion, which in turn can impact taxpayer behavior. Understanding the potential connection between procedural complexity and taxpayer behavior provides additional insight into how to improve tax compliance. By making the process of taxpaying less complicated, policy makers may be able to reduce tax evasion.

#### *A. Mental Depletion in Taxpayers*

The law of least effort says that we’d prefer to do less work whenever possible, including mental work. But complying with our various tax obligations can take an extraordinary amount of mental effort, particularly for certain types of taxpayers like sole proprietors, who must track numerous items of income and expense. Research also indicates that our mental reserves are a limited resource that can be depleted by tasks that require cognitive effort. The type of task itself does not appear to be as important as the amount of effort expended. Making choices among various products, exercising self-control by not looking at words flashing across a screen, writing text without using certain letters, and making parole decisions all have been shown to lead to mental depletion. What these various tasks have in common is that they all require sustained mental focus, and that focus is exhausting.

The procedural complexity of our tax laws is similarly exhausting. The number of forms and related documents potentially required for tax return preparation is evidence of this. For example, for 2016, Form 1040 was seventy-nine lines long with

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80. This was verified by comparing the results among depleted and nondepleted subjects who had their answers checked by an experimenter. *Id.*

81. Gino et al., *supra* note 67, at 194.

82. In this study, the researchers tracked actual performance on a computer and with a collection slip that indicated the participants’ lab ID. *Id.*

83. *Id.*

84. *Id.* at 195. Another study found that subjects cheated more in the afternoon and evening as compared to the morning, suggesting that the subjects’ daily activities depleted their mental energy. Maryam Kouchaki & Isaac H. Smith, *The Morning Morality Effect: The Influence of Time of Day on Unethical Behavior*, 25 PSYCHOL. SCI. 95 (2014).

nearly 100 pages of instructions.<sup>85</sup> Besides Form 1040, there are over 600 other tax forms and schedules and over 150 worksheets.<sup>86</sup> Taxpayers' obligations extend beyond year-end tax filing, as well. There are various recordkeeping requirements, and some taxpayers must estimate and pay taxes each quarter.<sup>87</sup>

### *B. Mental Depletion May Lead to Lower Tax Compliance*

The behaviors observed in empirical studies of mental depletion are relevant to tax compliance in several ways. First, mental depletion is linked to passivity. Individuals who have exhausted their mental resources tend to avoid active choices and are prone to stick with defaults.<sup>88</sup> Passivity is particularly relevant to our income tax system in the United States because we have a self-reporting system.<sup>89</sup> That is, each individual must make a return at year-end on which she voluntarily reports her income.<sup>90</sup> Under such a system, the status quo is to do nothing, or *not* report. Reporting income, particularly income that is not subject to tax withholding, is like the Israeli judges granting parole. It's active versus passive and a departure from the default. The effect of mental depletion on passivity potentially has enormous implications for tax compliance. If tax complexity is depleting taxpayers' limited mental resources and causing them to behave more passively, they could fail to act in important ways. For example, this could mean failing to report a household employee, failing to report cash income that hasn't been reported to the IRS by third parties, or failing to pay use taxes on a large purchase.<sup>91</sup>

In addition to passivity, mental depletion has also been linked to unethical behavior, like lying for monetary gain.<sup>92</sup> Intentionally misreporting the number of problems correctly solved in order to collect a bigger payout is analogous to

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85. FORM 1040, *supra* note 37; INTERNAL REVENUE SERV., DEP'T OF TREAS., 1040 INSTRUCTIONS (2016), <http://www.irs.gov/pub/irs-pdf/i1040gi.pdf> [<https://perma.cc/9KEK-DBNA>].

86. JCT Report, *supra* note 7, at 4. Of course, all of those forms will not be relevant for one particular taxpayer.

87. *See* I.R.C. § 6654(a) (2012).

88. *See supra* Part II.B.1.

89. Passivity would be less troubling in the context of taxes that do not require self-reporting, such as a retail sales tax that is automatically collected upon payment.

90. Although many taxpayers will have already satisfied their tax obligations through withholding and will have their income reported to the IRS by third parties, not all income is subject to these rules. For example, income earned by self-employed individuals generally is not subject to third-party reporting.

91. In a recent empirical study, researchers observed passivity in subjects who were subject to complex tax rules. Johannes Abeler & Simon Jäger, *Complex Tax Incentives*, 7 AM. ECON. J. 1 (2015). In the study, subjects had to attempt to maximize their compensation in a system of taxes and subsidies by adjusting their output from a simple task each time a new tax rule was introduced. *Id.* at 6–7. Unsurprisingly, those subject to fewer rules (the simple system) were able to better optimize their compensation than those subject to more rules (the complex system). *Id.* at 12. However, what's particularly interesting is that those in the complex system didn't just make the wrong decisions; they were also much more likely to fail to act altogether to adjust their output when a new tax rule was introduced, indicating a status quo bias. *Id.* at 14.

92. *See supra* Part II.B.3.

intentionally underreporting income in order to pay less tax (or receive a bigger tax refund). The latter is also a form of lying for monetary gain. To the extent that mental depletion makes it harder for people to resist the temptation to cheat, individuals faced with tax complexity may be more likely to underreport their income.

Finally, mental depletion has been linked to lower self-control more broadly. For example, people are less likely to stick to their diet or refrain from smoking if they have been mentally depleted.<sup>93</sup> Again, the idea appears to be that individuals lose their willpower to substitute desired behavior for less desirable behavior when their mental reserves are low. If tax complexity minimizes taxpayers' willpower, they may find themselves not complying despite their best intentions. In other words, taxpayers may have positive attitudes about paying what they owe, and consider themselves to be fundamentally honest people, but unable to motivate themselves to expend the mental effort to comply.<sup>94</sup>

### *C. Simpler Taxpaying Procedures Should Foster Better Tax Compliance*

Individuals tend to have more willpower, behave more honestly, and are more willing to make active decisions when they are not mentally depleted. Thus, if we want to encourage people to comply with their tax obligations—to not avoid them or ignore them—we should make it easier to comply. This means not just simplifying the substance of the tax code, as many have suggested. We should also make the *process* easier on taxpayers. Reducing procedural complexity should reduce the cognitive strain that taxpayers undoubtedly experience in their interactions with the tax system. Less cognitive effort should, in turn, lead to better taxpaying behavior.

Concededly, the application of mental depletion research to taxpayer behavior is uncertain and should be the subject of further study. But mental depletion is just one potential mechanism to explain the potential link between procedural complexity and tax compliance. Even apart from mental fatigue, taxpayers may evade taxes because they make a rational decision that the costs of their compliance obligations are too high when weighed against the benefits. For example, one IRS study of audit data found that taxpayers generally reported more income when compliance costs were lower, even when the IRS lacked significant information about that income.<sup>95</sup> The authors of the study further concluded that taxpayers tend to err on the side of under reporting versus over reporting when they perceive compliance costs are high, stating “taxpayers are more likely to *choose* inaccuracy over exerting the effort to be accurate when the ‘easy-to-report’ amount is relatively lower than the expected true amount.”<sup>96</sup>

Further, while the empirical studies discussed above support the notion that procedural complexity impacts tax compliance, so do our commonsense intuitions. If the government wants taxpayers to *voluntarily* report and pay tax on income that

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93. See *supra* note 58 and accompanying text.

94. Anecdotally, several friends and acquaintances have told me, “I would pay [whatever tax is owed] if they just made it easier.” This has come up most often with respect to taxes on household employees, like babysitters.

95. PHILIPS & PLUMLEY, *supra* note 38, at 32.

96. *Id.* at 35.

it doesn't already know about, shouldn't it make things as easy as possible on the taxpayers that it wants to encourage?

To be sure, some individuals would evade their tax obligations regardless of how simple it was to comply, particularly those who cheat because the likelihood of detection is low. We can think of these taxpayers as *Determined Cheaters*. Determined Cheaters will generally evade as much as they can without getting caught.<sup>97</sup> Or, a Determined Cheater may have such a strong emotional aversion to the tax system that he will always cheat to some extent out of principal, perhaps because he thinks taxes are inherently unfair. On the other end of the spectrum are the *Honest Taxpayers*, those who will report all of their income accurately under all circumstances, even when the effort required is significant and the odds of detection for underreporting are very low. Procedural simplification is unlikely to impact compliance among either Determined Cheaters or Honest Taxpayers.

However, the proposals in this Article are aimed at a third group of taxpayers in the middle of the spectrum, who I call the *Taxpayers On The Fence*. Taxpayers On The Fence may cheat or not cheat depending on the circumstances,<sup>98</sup> such as the effort required to comply. A Taxpayer On The Fence might report cash income on his tax return, even if it wasn't reported on a Form 1099, as long as he has a record of the income and the process for reporting it is relatively simple. But he might not pay employment taxes on a household employee if he decides the process entails too many steps and requires too much effort.<sup>99</sup>

Unfortunately, IRS data indicates that less than half of individuals are Honest Taxpayers.<sup>100</sup> As for Determined Cheaters, improving tax compliance among this group would entail significantly raising tax penalties and/or the audit rate, both of which would be costly and politically infeasible.<sup>101</sup> But policy makers should not overlook Taxpayers On The Fence, those taxpayers for whom compliance rates can be improved with less costly policies aimed at nudging<sup>102</sup> them in the right direction.

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97. In other words, a Determined Cheater won't pay tax owed unless the perceived penalty for evasion outweighs the perceived benefit, something that is highly unlikely for taxpayers who are not subject to any third-party information reporting (e.g., a sole proprietor).

98. For this purpose, I am assuming that the level of detection and the penalty for evasion are constant and therefore are not potential circumstances that would push a Taxpayer On The Fence in one direction or the other.

99. The "nanny tax" is discussed further below in Part IV.

100. Although overall compliance rates are much higher than fifty percent, when looking at income that is not subject to any third-party information reporting or withholding, only forty-four percent is reported accurately. See INTERNAL REVENUE SERV., *supra* note 2. Further, an estimated sixty-one percent of sole proprietors earning such income underreport their tax liability. JAMES R. WHITE, U.S. GOV'T ACCOUNTABILITY OFF., GAO-07-1014, TAX GAP: A STRATEGY FOR REDUCING THE GAP SHOULD INCLUDE OPTIONS FOR ADDRESSING SOLE PROPRIETOR NONCOMPLIANCE 3 (2007), <http://www.gao.gov/assets/270/265399.pdf> [<https://perma.cc/RVX6-CB2Z>] (based on tax gap data for 2001). However, wage earners, whose income is withheld and reported on a Form W-2, have very little opportunity to cheat, and it's possible that a greater proportion of them would still be Honest Taxpayers if they did have the opportunity.

101. See Kathleen DeLaney Thomas, *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*, 67 TAX L. REV. 111, 124 (2013).

102. See RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT

Procedural simplification is a promising means of improving tax compliance among this group.<sup>103</sup>

There are other upsides to procedural simplification that should not be overlooked, the biggest of which is the potential efficiency gain. As scholars have noted, the hours spent by taxpayers (and their advisors) complying with tax-filing and recordkeeping obligations amounts to deadweight loss, and policies that reduce this time should produce social gains.<sup>104</sup> This potential cost reduction itself makes procedural simplification a worthy goal. However, the potential increase in voluntary compliance is an additional component of the cost-benefit analysis. Encouraging individuals to report more honestly by simplifying the process should result in increased tax revenues, which is an additional benefit beyond reducing deadweight loss. Moreover, enhancing compliance in this manner may have positive spillover effects. Reduced time and effort may engender more positive feelings about the government and/or paying taxes, which may further promote voluntary compliance among Taxpayers On The Fence.<sup>105</sup>

Of course, substantive tax complexity could also contribute to mental depletion, which could in turn cause lower tax compliance among Taxpayers On The Fence. A taxpayer struggling to understand a complicated tax rule will expend her limited mental resources and may become depleted. Or she may perceive that the cost of trying to understand the rule is too high and decide to underreport. But there are several reasons that this Article focuses on reducing procedural complexity.

First, many taxpayers can and presumably do avoid the substantive complexity of the tax code. They may not even attempt to understand the underlying rules or quickly give up if a substantive rule isn't clear to them and seek advice. Procedural complexity, on the other hand, is unavoidable to some extent. Even taxpayers who take a minimal role in complying with their tax obligations—those who use a return preparer for example—are forced to have some interaction with the tax system. At the very least they may have to fill out tax forms for their employer, maintain records during the year, collect tax forms that are mailed to them at the end of the year, and correspond with their tax preparer about their tax situation. All of these tasks involve some degree of procedural complexity. Further, while substantive simplification has its own merits, procedural simplification is a more attainable goal. Rather than re-writing the tax code, policy makers can make significant headway towards procedural simplification through smaller measures like redesigning tax forms or the IRS website, as discussed in the next Part.

#### IV. TAX POLICY IMPLICATIONS

This part discusses some specific tax policy proposals aimed at increasing tax

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HEALTH, WEALTH, AND HAPPINESS (Penguin Books 2009) (2008) (coining the term “nudge” to refer to behavioral interventions).

103. Empirical studies support the notion that some taxpayers are influenced by behavioral nudges, as discussed below in Part IV.D.

104. See, e.g., SLEMROD & BAKIJA, *supra* note 20, at 160–63.

105. Leandra Lederman has described a similar effect with respect to IRS enforcement, which she argues “not only produces direct revenue, but also increases revenue from ‘voluntary’ compliance.” Lederman, *supra* note 3, at 1513.

compliance by making the process of taxpaying easier. The private sector and other areas of government have already caught on to this concept, and the idea of making products and processes more user-friendly has become increasingly popular. Accordingly, this part begins by examining examples from industries such as marketing and website design, as well as other areas of government regulation, before turning to tax policy.

### *A. Lessons from the Private Sector*

#### **1. Product Marketing**

Marketing professionals have long understood that selling more products means understanding the psyche of their customers. One important finding by marketing researchers is that customers are overwhelmed in the face of too much information or too many choices and are, therefore, less likely to purchase a product. For example, customers at a supermarket were far more likely to purchase jam from a table with six options (thirty percent of customers purchased jam) as compared to a table with twenty-four options (only three percent purchased).<sup>106</sup>

One comprehensive study of over 7000 consumers examined what makes customers “sticky,” that is, more likely to follow through on a purchase, make repeat purchases, and recommend a product to others.<sup>107</sup> The results showed that “[t]he single biggest driver of stickiness, by far, was ‘decision simplicity’—the ease with which consumers can gather trustworthy information about a product and confidently and efficiently weigh their purchase options. What consumers want from markets is, simply, simplicity.”<sup>108</sup>

So how have marketing professionals incorporated these findings into product design? One important lesson is that companies should present consumers with the *minimal* amount of information they need to make a purchase decision.<sup>109</sup> This might entail, for example, listing a few key features of products on signs in a store but omitting specifications that are less important to consumers. Savvy companies also streamline the decision-making process for their consumers, making it quick and easy whenever possible. For example, one successful shampoo company has an online decision tool that helps consumers pick a product: “The guide provides substantial detail but also makes narrowing and tailoring one’s choice an easy, transparent, step-by-step process. One-click questions about hair-type, length, and texture . . . and other needs . . . allow the visitor to rapidly sort through more than three dozen offerings to find the ideal one.”<sup>110</sup>

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106. Sheena S. Iyengar & Mark R. Lepper, *When Choice Is Demotivating: Can One Desire Too Much of a Good Thing?*, 79 J. PERSONALITY & SOC. PSYCHOL. 995, 997 (2000).

107. Patrick Spenner & Karen Freeman, *To Keep Your Customers, Keep It Simple*, HARV. BUS. REV., May 2012, at 108.

108. *Id.* at 110.

109. *Id.* at 113.

110. *Id.* at 113–14. Researchers have also found that consumers’ lack of attention to multiple options may cause them to adhere to defaults. *See generally* Stefania Sitzia, Jiwei Zheng & Daniel John Zizzo, *Inattentive Consumers in Markets for Services*, 79 THEORY & DECISION 307, 309 (2015).



## 2. Website Design

Experts in internet technology have also embraced simplicity. Steve Krug highlights the importance of simplicity and ease in his widely read book on web usability, aptly titled *Don't Make Me Think*.<sup>111</sup> Although the focus of the book is on websites and mobile applications, Krug states that his usability principles apply to “anything people have to interact with,” for example, an election ballot or voting booth.<sup>112</sup> The ultimate goal in design is for one’s website or other product to be *usable* (or user-friendly), which Krug defines as meaning that “[a] person of average (or even below average) ability and experience can figure out how to use the thing to accomplish something without it being more trouble than it’s worth.”<sup>113</sup> In other words, the key is simplicity.

Krug’s first principle is that if you want someone to use your website (or product), they should be able to use it with minimal mental effort. This means that when a person visits a website for the first time, it should be self-evident what the point of the website is, where things are located, and how to use it. Any feature that is not obvious forces people to “puzzle” over how to use the site, which drains mental resources and distracts us.<sup>114</sup> Anything that cannot be made self-evident should be made self-explanatory, by relying on features like size, color and layout of text, well-thought-out names, and minimal amounts of carefully chosen text.<sup>115</sup>

Krug goes on to describe important aspects of how web users tend to consume and process information. For example:

- People tend not to read pages but, rather, they scan them quickly and look for key information;
- people are generally in a hurry. They don’t necessarily choose the best option, they choose the first reasonable one;
- people generally don’t read instructions and prefer to “muddle through.” They generally don’t care how things work if they are able to use them;
- people generally tolerate more steps (“clicks” on a website) if they require little thought and effort, as opposed to fewer steps that require a lot of thought; and
- if people cannot find what they are looking for without a lot of effort, they will leave.<sup>116</sup>

Understanding the behavior of web users, in turn, suggests further ways to improve website usability. Based on our behavioral tendencies, Krug recommends (among many other suggestions): formatting text in a way that makes it easier to scan (e.g., by using headings and visual hierarchies or highlighting certain text), making it obvious which parts of a website are “clickable,” removing any unnecessary words or other information, and eliminating instructions whenever possible.<sup>117</sup>

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111. STEVE KRUG, *DON'T MAKE ME THINK, REVISTED: A COMMON SENSE APPROACH TO WEB USABILITY* (3d ed. 2014).

112. *Id.* at 8.

113. *Id.* at 9.

114. *Id.* at 11–15.

115. *Id.* at 18.

116. *Id.* at 22, 24–26, 43, 51, 59.

117. *See id.* at 29–51.

### *B. Simplification in Practice*

These simplicity principles have been successfully implemented in a number of real world settings. For example, offering employees a simplified procedure to enroll in a 401(k) plan—one where the contribution rate and asset allocation are preselected by the employer—has been shown to significantly increase 401(k) enrollment.<sup>118</sup> Additionally, offering chronically ill patients simplified dosing procedures has been shown to increase compliance with prescribed medication regimens.<sup>119</sup> Regulators have also embraced simplification as a means to increase uptake in government programs.<sup>120</sup> Cass Sunstein, the former Administrator of the White House Office of Information and Regulatory Affairs, notes that government agencies have produced seventy-two simplification initiatives in recent years in response to a request from the Obama administration to “increase administrative simplification” and promote more electronic reporting.<sup>121</sup> For example, the Free Application for Federal Student Aid (FAFSA) has been made shorter, simpler, and more automated, with the goal of increasing access to college.<sup>122</sup> And the Treasury Department has implemented an electronic delivery system for recipients of Social Security and Supplemental Security Income benefits, under which individuals automatically receive the funds on a prepaid debit card.<sup>123</sup> In making his case for simplified procedures across all areas of government, Sunstein argues that “[c]omplexity can have serious unintended effects (including indifference, delay, and confusion), potentially undermining regulatory goals by reducing compliance or decreasing the likelihood that people will benefit from various policies and programs.”<sup>124</sup>

### *C. Making Taxpaying More User-Friendly*

Policy makers who wish to encourage taxpayers to comply with their tax obligations should keep the above-described principles in mind. By making people’s interactions with the tax system more user-friendly, we should be able to encourage more voluntary participation. The remainder of this part explores specific policy proposals with that goal in mind.

#### 1. More Information Reporting

One way that policy makers could ease the burden of taxpaying is to subject more

118. James J. Choi, David Laibson & Brigitte C. Madrian, *Reducing the Complexity Costs of 401(k) Participation Through Quick Enrollment*, in DEVELOPMENTS IN THE ECONOMICS OF AGING 57 (David A. Wise ed. 2009).

119. Sripal Bangalore, Gayathri Kamalakkannan, Sanobar Parkar & Franz H. Messerli, *Fixed-Dose Combinations Improve Medication Compliance: A Meta-Analysis*, 120 AM. J. MED. 713, 713 (2007).

120. Cass R. Sunstein, Essay, *Empirically Informed Regulation*, 78 U. CHI. L. REV. 1349, 1402–04 (2011).

121. *Id.* at 1403.

122. *Id.* at 1402.

123. *Id.* at 1403. Notably, the card is not available for receipt of a tax refund.

124. *Id.* at 1402.

income to third-party information reporting.<sup>125</sup> The most obvious upside of information reporting is the clear deterrence benefit: income that is reported to the IRS by third parties is all but impossible for taxpayers to conceal without detection. But information reporting provides a simplification benefit, as well, that should not be overlooked.

Certain types of income, like self-employment income and some income earned by independent contractors, is not reported to the IRS by third parties.<sup>126</sup> Unsurprisingly, there is a significantly lower tax compliance rate for such income (only forty-four percent reported accurately).<sup>127</sup> Although increased opportunity to cheat undoubtedly plays a role in lower compliance here, there is also increased procedural complexity for taxpayers who earn income that is not subject to information reporting. An enormous advantage of information reporting for taxpayers is that it is essentially equivalent to recordkeeping by the third parties that report the income. Taxpayers who earn income that is not reported by third parties may fail to report accurately not just because they think they can get away with it, but because they were too lazy to keep proper records.

Consider a taxpayer who earns various types of investment income in the form of interest and dividends from multiple accounts. For each of those accounts, he will receive a Form 1099-INT reporting the income he earned at year-end, which he is likely to rely on to prepare his tax return. Not receiving those tax forms would require the taxpayer to consult his records with each financial institution to determine the amount of taxable income (if any) for the year. It would also require him to keep track of which accounts were taxable and which were not. In isolation these are seemingly simple tasks, but in the aggregate they impose additional procedural burdens on taxpayers who are already disinclined to put effort into taxpaying.

Not all income is amenable to third-party information reporting.<sup>128</sup> For example, cash income earned from selling products to consumers wouldn't be a good candidate because it would be impracticable to require consumers to send the IRS an information statement based on each individual purchase.<sup>129</sup> But the justification for not requiring information reporting on other types of income is less clear. For example, payments made to independent contractors for services are generally reportable on Form 1099-MISC if the payments exceed \$600, but the payments are *not* reportable if the payments are made for goods instead of services, or if the payments are made to a corporation instead of an individual.<sup>130</sup> There does not appear to be a strong

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125. An example of third-party information reporting is when a bank reports interest income to the taxpayer on Form 1099-INT. The taxpayer receives the tax form from the bank and uses the information to report her interest income on her tax return. The bank also sends the information to the IRS.

126. See INTERNAL REVENUE SERV., *supra* note 2, tbl.1.

127. See *id.* On the other hand, income subject to substantial information reporting has a ninety-two percent compliance rate. *Id.*

128. For an in-depth discussion of what kinds of income are best suited for information reporting, see Leandra Lederman, Essay, *Reducing Information Gaps To Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733 (2010).

129. However, certain credit card purchases do have to be reported by the credit card company. See I.R.C. § 6050W (2012).

130. The payments are only reportable if they are made in the course of the payor's trade

justification for these carve-outs, and information reporting could be expanded here to cover sales of goods for more than \$600 and payments to corporations.<sup>131</sup> Where more third-party information reporting is feasible, policy makers should consider requiring it to further simplify taxpaying and improve compliance.<sup>132</sup>

## 2. Taxpayer Accounts

Policy makers could also reduce procedural complexity for taxpayers through the use of online taxpayer accounts. These accounts should incorporate two key features. First, they should constitute a “one stop shop” where taxpayers can manage various aspects of their tax situation online in a single location. Second, they should allow for automatic retrieval of third-party information returns, as discussed more below.

### a. Online Taxpayer Portal

Each taxpayer should be provided with access to a secure online portal that contains easily accessible personal tax information and links to relevant tax resources. The IRS had already started to build a similar online portal system for taxpayers called “My IRS Account,” but the project was cancelled in 2009 after nearly three years of development.<sup>133</sup> The My IRS Account project was intended to unify already existing IRS portals<sup>134</sup> and allow taxpayers to access and manage certain tax information online, similar to online banking.<sup>135</sup> Treasury officials cited inadequate funding and the absence of a “viable, agreed-upon . . . business strategy” as the reason for the cancellation of the project.<sup>136</sup>

Developing an online taxpayer account is no less important today, despite the

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or business. Certain payments to corporations are reportable, such as attorney’s fees. *See* I.R.C. § 6041(a) (2012); *see also* INTERNAL REVENUE SERV., DEP’T OF TREAS., INSTRUCTIONS FOR FORM 1099-MISC 2 (2017), <http://www.irs.gov/pub/irs-pdf/i1099misc.pdf> [<https://perma.cc/2KH2-L9UQ>].

131. *See* Lederman, *supra* note 128, at 1744–48 (discussing eliminating the corporate payee exception).

132. However, the potential compliance gains derived from increased information reporting would have to be weighed against the increased compliance costs imposed upon the parties that bear the burden of the reporting.

133. Amy S. Elliott, *IRS Should Pursue Online Taxpayer Portal, Official Says*, 129 TAX NOTES 965 (Nov. 29, 2010).

134. For example, there is currently a web portal called “Where’s my refund?” on IRS.gov where taxpayers can check the status of their tax refund. *Where’s My Refund? – It’s Quick, Easy and Secure*, IRS, <http://www.irs.gov/Refunds/Where%27s-My-Refund-It%27s-Quick,-Easy,-and-Secure> [<https://perma.cc/S6QR-49AS>] (last updated Feb. 16, 2017). The IRS also released a “Get Transcript” tool in 2014 that allows taxpayers to immediately access copies of their IRS transcripts for past tax years. *See Welcome to Get Transcript*, IRS (last updated Mar. 7, 2017), <http://www.irs.gov/Individuals/Get-Transcript> [<https://perma.cc/WFN4-M2AM>].

135. Elliott, *supra* note 133; *see also* Nicole Duarte, *IRS Web Portal Program Scrapped Because of Weak Business Plan, TIGTA Says*, 2009 TAX NOTES TODAY 97-6 (May 22, 2009). The program was not intended to incorporate automatic retrieval of third-party-reported data, however.

136. Duarte, *supra* note 135.

2009 failure of the My IRS Account project for lack of a clear vision. The Electronic Tax Administration Advisory Committee (ETAAC) recently recommended reviving the project in its 2014 Annual Report to Congress,<sup>137</sup> calling for a “[s]ecure, personalized online IRS account . . . that increases voluntary compliance, decreases burden, lowers IRS customer service costs, and encourages e-filing.”<sup>138</sup> The EAATC members noted that successful companies like banks and retailers have already taken a “comprehensive approach to the online customer experience,” and the IRS should follow suit.<sup>139</sup>

These ETAAC recommendations call for a single online platform on which taxpayers could access some tax information, manage certain tax affairs, and interact with the IRS.<sup>140</sup> One important aspect of the account proposed by the ETAAC would be integrating online services already available to taxpayers (as the My IRS Account project intended), like checking tax refund status, retrieving tax transcripts, and making tax payments.<sup>141</sup> The ETAAC members also recommend allowing taxpayers to view communications from the IRS online, view the status of unresolved tax issues, address underpayments and penalties, and respond to IRS inquiries.<sup>142</sup> They further recommend that the account provide tools specific to the individual’s tax situation, such as an interactive tool for the Earned Income Tax Credit for a low-income individual.<sup>143</sup> Several states have already instituted online taxpayer accounts that allow taxpayers to do things like pay tax bills, manage estimated tax accounts, receive email notifications of items like refunds and bills, and view their payment history.<sup>144</sup>

Providing numerous taxpayer services in one place would greatly simplify taxpaying. As recommended by the ETAAC, the online account should allow taxpayers to do things like communicate with the IRS, view and pay bills, and access interactive tools relevant to their specific tax situation. Those tools should be modeled on web usability principles and should therefore be self-explanatory and easy to navigate with minimal effort. The time and effort taxpayers currently must spend to

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137. ELEC. TAX ADMIN. ADVISORY COMM., PUB. 3415, ANNUAL REPORT TO CONGRESS, JUNE 2014 (2014), <https://www.irs.gov/pub/irs-prior/p3415--2014.pdf> [<https://perma.cc/SE4E-BC35>]. The ETAAC was authorized and formed by Congress in 1998 to “provide input to the Internal Revenue Service (IRS) on the development and implementation of the IRS strategic plan for electronic tax administration.” *Id.* at iii.

138. *Id.* at 24.

139. *Id.* The report notes that over half of Americans used online banking in 2013, and that online retail sales continue to outpace those in stores. *Id.* at 24–25. Consumers have also demonstrated increasing demand for online services from the IRS, with growing numbers of visits to the IRS website (457 million in 2013) and increasing rates of e-filing tax returns (eighty-one percent in 2013). *Id.* at 25.

140. *Id.* at 24.

141. *Id.* at 27.

142. *Id.* at 30.

143. *Id.*

144. *Id.* at 29. States with such accounts include California, Illinois, Maryland, New York, and Oregon. *Id.* at 29 n.67; see also STATE OF CAL., FRANCHISE TAX BD., PIVOTING AWAY FROM PAPER (2014) [hereinafter FTB REPORT], [http://www.treasury.gov/IRSOB/meetings/Documents/2014/CA\\_FTB.pdf](http://www.treasury.gov/IRSOB/meetings/Documents/2014/CA_FTB.pdf) [<https://perma.cc/2BAQ-E26W>].

track down resources for various tasks in different places causes them to expend precious mental energy.<sup>145</sup>

The government has already implemented a similar system to allow individuals to enroll for healthcare via the government website HealthCare.gov. HealthCare.gov is an online marketplace that allows insurance consumers to compare and shop for different insurance plans, enroll in plans, obtain information about relevant dates and deadlines, find local help centers, or access online help all in one place.<sup>146</sup> Because insurance coverage is now required under the Affordable Care Act, the goal of the site is to make enrollment as user-friendly as possible to encourage compliance with the new requirements.<sup>147</sup> Although the initial rollout of the website was plagued with numerous technical difficulties,<sup>148</sup> the site was essentially functioning as intended by the fall of 2014.<sup>149</sup> By similarly streamlining the taxpaying process for individuals through use of a one-stop online portal, policy makers can encourage better tax compliance.

#### b. Third-Party Data Retrieval

Instituting an online account like that envisioned by the ETAAC would be enormously beneficial to taxpayers. Additionally, to further simplify the taxpaying process, the accounts should allow taxpayers to access and review all of their third-party information returns online (which is not contemplated by the current ETAAC

145. One self-employed taxpayer with whom I discussed this proposal told me that one of the biggest headaches of self-preparing his tax return is that IRS publications frequently cross-reference one another, and he can never find all of the publications he needs in one place. The result, he said, is that he spends a lot of time having to go look for new documents. A self-employed taxpayer should be able to access a personal tax page that links to all relevant tax forms, instructions, and publications from one place.

146. HEALTHCARE.GOV, <https://www.healthcare.gov> [<https://perma.cc/PF28-KWWM>].

147. See, e.g., Alex Wayne, *New Healthcare.gov CEO Pursues User-Friendly Goal*, TELEGRAM.COM (Oct. 2, 2014), <http://www.telegram.com/article/20141002/NEWS/310029628/1237#> [<https://perma.cc/73C9-7LFE>].

148. See, e.g., MAJORITY STAFF OF H. COMM. ON OVERSIGHT AND GOV'T REFORM, BEHIND THE CURTAIN OF THE HEALTHCARE.GOV ROLLOUT (2014), <http://oversight.house.gov/wp-content/uploads/2014/09/Healthcare-gov-Report-Final-9-17-14.pdf> [<https://perma.cc/4EFR-FZJV>]; Ricardo Alonso-Zaldivar, *HealthCare.gov Marred by Technical Problems on Signup Deadline Day*, PBS NEWSHOUR: RUNDOWN (Mar. 31, 2014, 9:28 AM), <http://www.pbs.org/newshour/rundown/healthcare-gov-nearly-4-hours-signup-deadline-day> [<https://perma.cc/6B74-Z7TB>]; Ed Payne, Matt Smith & Tom Cohen, *Report: Healthcare Website Failed Test Ahead of Rollout*, CNN POLITICS (Oct. 22, 2013, 9:03 PM), <http://www.cnn.com/2013/10/22/politics/obamacare-website-problems> [<https://perma.cc/P8Z9-NMSP>].

149. For example, over one million people applied for coverage during the first week of enrollment in the fall of 2014. See Robert Pear, *In First Week, More Than a Million Apply for Health Insurance on Federal Website*, N.Y. TIMES (Nov. 26, 2014), [https://www.nytimes.com/2014/11/27/us/politics/obamacare-aca-1-million-sign-ups.html?\\_r=1](https://www.nytimes.com/2014/11/27/us/politics/obamacare-aca-1-million-sign-ups.html?_r=1) [<https://perma.cc/FC8Z-ALZL>]; see also Robert Pear, *Some Hiccups, but Federal Health Exchange Website Is in Good Health*, N.Y. TIMES (Nov. 16, 2014), <https://www.nytimes.com/2014/11/17/us/politics/some-hiccups-but-federal-health-exchange-website-is-in-good-health.html> [<https://perma.cc/JTD5-7U2D>].

proposal). All Forms 1098 or 1099 that would be mailed to the taxpayer by third parties would be automatically posted online and viewable from the taxpayer's account.<sup>150</sup> When it comes time to file a tax return, the online portal should allow taxpayers to automatically transfer all of this data onto their tax return. This would, for example, obviate the need for taxpayers to manually input information related to sales of investments (reported on Form 1099-B) into a software program, as described above in Part I.<sup>151</sup>

Several commentators have advocated for such a "data retrieval" system,<sup>152</sup> which could import the information onto the correct line item on the taxpayer's return and make simple calculations such as adding up all of one's interest income.<sup>153</sup> They have noted that such a system would allow taxpayers to avoid the burden of collecting paper statements, figuring out which line to report them on, and manually entering the information (whether with software or by hand), along with eliminating potential anxiety over having lost a Form 1099.<sup>154</sup> A large amount of taxpayer data already subject to information reporting could be included in the data retrieval system, such as certain independent contractor income, income from interest, dividends, and capital gains from a brokerage account, state income tax refunds, royalties, shares of partnership gains and losses, deductible mortgage interest, and deductible state and local property taxes.<sup>155</sup>

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150. One important concern here would be security, both in the objective sense (would taxpayers' data be secure?) and from a public perception standpoint (would taxpayers be afraid to use the accounts because of security concerns?). Ajay Mehrotra argues that "recent experiences with national-security surveillance, the initial implementation of the Affordable Care Act, and breaches of online privacy" indicate that "the federal government is not the best institution to provide . . . a clearinghouse of third-party information." Ajay Mehrotra, *Reviving Fiscal Citizenship*, 113 MICH. L. REV. 943, 966 (2015) (reviewing ZELENAK, *supra* note 11). However, private companies face security breaches too, so security concerns don't necessarily mean the government's management of online data is inferior. Additionally, improvements in technology and learning from past mishaps should make secure databases increasingly difficult to breach in future years. Taxpayer concerns could be eased over time by slowly rolling out new products among smaller groups of willing participants first.

151. As summarized in the table in Part I, reporting proceeds from sales of investments (reported by brokers on Form 1099-B) is an example of low substantive complexity accompanied by high procedural complexity.

152. See ZELENAK, *supra* note 11, at 124; Joseph Bankman, *Using Technology To Simplify Individual Tax Filing*, 61 NAT'L TAX J. 773 (2008); Dennis J. Ventry Jr., *Americans Don't Hate Taxes, They Hate Paying Taxes*, 44 U.B.C. L. REV. 835 (2011); Jay A. Soled, *Requiem for Paper Information Statements*, 128 TAX NOTES 658 (Aug. 9, 2010).

153. Bankman, *supra* note 152, at 775.

154. *Id.*; Soled, *supra* note 152. Soled notes that the workload of the third parties reporting information would also be reduced because they would only have to provide the information to the IRS (who would provide it to the taxpayer), rather than having to provide it separately to the IRS and taxpayers. *Id.*

155. Bankman, *supra* note 152, at 774; Ventry, *supra* note 152, at 863. The idea of online access to third-party data and an associated taxpayer account has gained traction in recent years. Data retrieval was endorsed by President Obama's Economic Recovery Advisory Board in 2010, by the then-commissioner of the IRS in 2010 and by the IRS's Electronic Tax Administration Advisory Committee in 2007. See Bankman, *supra* note 152, at 775; Ventry, *supra* note 152, at 865; see also ECON. RECOVERY ADVISORY BD., THE REPORT ON TAX

Instituting an integrated online taxpayer account would be an important step towards reducing the procedural complexity of the taxpaying process. Further, allowing for data retrieval would greatly simplify tax return preparation for a significant number of taxpayers. Requiring taxpayers to collect and keep track of information returns and then manually enter the information during the tax-preparation process<sup>156</sup> creates an unnecessary headache, particularly given that the IRS *already has the information* from the third parties that reported it. Allowing taxpayers to automatically view and retrieve the information in one place would be a worthwhile reduction of effort for taxpayers with little or no added effort for the third-party reporters.<sup>157</sup>

### 3. Simplified Tax Returns

A taxpayer's personal tax account should also be linked to an online version of the taxpayer's annual tax return. Online tax data such as that reported on Form 1099 should be automatically transferrable to the return. There are several options to simplify the process of online tax return preparation,<sup>158</sup> and the federal government and some states have already considered some of them. As discussed below, this Article argues that simplified, taxpayer-prepared returns are preferable to government-prepared tax returns.

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REFORM OPTIONS: SIMPLIFICATION, COMPLIANCE, AND CORPORATE TAXATION (2010), <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Tax-Reform-Options-2010.pdf> [<https://perma.cc/L5JY-5SSX>]; ELEC. TAX ADMIN. ADVISORY COMM., ANNUAL REPORT TO CONGRESS 35–36 (2011), <http://www.irs.gov/pub/irs-prior/p3415--2011.pdf> [<https://perma.cc/6MTX-6B3K>]; Doug Shulman, *Prepared Remarks of IRS Commissioner Doug Shulman at the National Press Club*, INTERNAL REV. SERV. (Apr. 6, 2011), <http://www.irs.gov/uac/Prepared-Remarks-of-IRS-Commissioner-Doug-Shulman-at-the-National-Press-Club-1> [<https://perma.cc/SZP7-MCNV>].

156. This assumes the taxpayer does not use a tax-return preparer. But even taxpayers that use preparers have to collect and keep track of their information returns so that they can be turned over to the preparer.

157. In fact, their efforts should also be reduced. *See supra* note 154. Another potential issue would be whether the third-party data could be made available in time for taxpayers to file their returns. But although data retrieval may require the third-party reporters to provide information to the IRS on a slightly accelerated basis, states like California have demonstrated that it is possible and not unduly burdensome. *See Bankman, supra* note 152, at 777–78 (noting that companies would have to provide data one to two months earlier or move to a system where they provided it quarterly); *see also* Ventry, *supra* note 152, at 871.

158. Another simplification option is to shift to an entirely return-free tax system. This could be accomplished for some taxpayers through an exact-withholding regime, such as that used in countries like the United Kingdom, Japan, and Germany, where a taxpayer's entire tax liability is satisfied through withholding during the year. *See* DEP'T OF TREAS., REPORT TO THE CONGRESS ON RETURN-FREE TAX SYSTEMS: TAX SIMPLIFICATION IS A PREREQUISITE 7 (2003), <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Return-Free-2003.pdf> [<https://perma.cc/5GBQ-QGJT>]. However, a Treasury report that studied return-free filing concluded that the underlying tax laws in the United States would have to be substantially simplified before such a regime were feasible. *See id.* at 2–6. A return-free system could also be accomplished by shifting to a consumption tax, which would also require a substantive overhaul of our tax laws. *See, e.g.,* GRAETZ, *supra* note 24, at 198–204.



## a. Government-Prepared Tax Returns

One possibility is to shift to a “tax agency reconciliation system,” whereby the IRS would prepare the taxpayer’s return for her based on information reported by third parties.<sup>159</sup> The taxpayer could have the option to review the return online, make necessary additions, correct any errors, and electronically sign and file it. Third-party-reported data could automatically be imported onto a Form 1040 and simple calculations made for the taxpayer. Because not all income and deductions are subject to third-party information reporting, many taxpayers (e.g., those who earned cash income or claimed itemized deductions like charitable contributions) would have to make manual additions to supplement the return.<sup>160</sup>

Several legal and economic experts have advocated for a federal tax reconciliation agency system,<sup>161</sup> and a “simple return” bill calling for government-prepared tax returns has twice been introduced in Congress.<sup>162</sup> However, the idea has failed to gain political traction at the federal level, in large part due to staunch opposition by the tax-preparation software industry.<sup>163</sup> California instituted a tax agency reconciliation program in 2007 called ReadyReturn, under which eligible taxpayers can elect to review and file a pre-prepared state tax return.<sup>164</sup> That program also faced fierce industry opposition from companies like Intuit (the maker of TurboTax software),<sup>165</sup> and thus far it appears only a small percentage of those California taxpayers eligible to use the program are doing so.<sup>166</sup>

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159. DEP’T OF TREAS., *supra* note 158, at 11.

160. About forty percent of taxpayers claim the standard deduction and earn only income subject to information reporting, which would allow them to file an unrevised return. ZELENAK, *supra* note 11, at 121–22.

161. See, e.g., AUSTAN GOOLSBEE, THE ‘SIMPLE RETURN’: REDUCING AMERICA’S TAX BURDEN THROUGH RETURN-FREE FILING (2006), <https://www.brookings.edu/wp-content/uploads/2016/06/200607goolsbee.pdf> [<https://perma.cc/7XVJ-KU6>]; ZELENAK, *supra* note 11, at 121–23; Bankman, *supra* note 152, at 782–83.

162. H.R. 1069, 112th Cong. (2011); Bipartisan Tax Fairness and Simplification Act of 2011, S. 727, 112th Cong. (2011).

163. See, e.g., Liz Day, *How the Maker of TurboTax Fought Free, Simple Tax Filing*, PROPUBLICA (Mar. 26, 2013, 5:00 AM), <http://www.propublica.org/article/how-the-maker-of-turbotax-fought-free-simple-tax-filing> [<https://perma.cc/4LFH-J7US>].

164. See FTB REPORT, *supra* note 144, at 3; Bankman, *supra* note 152, at 783–85. Only taxpayers with relatively simple tax situations—those who are single, earn wage income only, and do not itemize—are eligible. See CAL. FRANCHISE TAX BD., FTB 971, READYRETURN SERVICE—FREQUENTLY ASKED QUESTIONS 1 (2007), <https://www.ftb.ca.gov/readyReturn/readyreturn.971.pdf> [<https://perma.cc/9HGD-SMRT>]. Government-prepared returns are used in some other countries, as well. Joseph Bankman, Clifford Nass & Joel Slemrod, *Using the “Smart Return” To Reduce Tax Evasion* 20 (Stanford Public Law Working Paper No. 2578432, 2015), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2578432](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2578432) [<https://perma.cc/58AV-HN3L>] (Finland and Sweden).

165. See ZELENAK, *supra* note 11, at 122.

166. In 2008, just over 60,000 taxpayers filed ReadyReturns out of nearly two million who were eligible. STATE OF CAL., FRANCHISE TAX BD., REPORT TO THE LEGISLATURE 4 (2009), <https://www.ftb.ca.gov/readyReturn/ReadyReturnReport2009.pdf> [<https://perma.cc/U3TC-YJ4D>]. In 2014, only 75,000 ReadyReturns were filed. FTB REPORT, *supra* note 144, at 3. However,

Advocates of federal government-prepared returns have argued that they would not only greatly reduce taxpayer time and effort, but that they would also promote “fiscal citizenship” by reducing negative feelings about paying taxes.<sup>167</sup> The idea behind the latter argument is that filing taxes connects us to the income tax system in a meaningful way, and thus active participation in the process should be encouraged.<sup>168</sup> On the other hand, there has been criticism of programs like ReadyReturn beyond pressure from the tax software companies. For example, some have argued that federal pre-prepared returns would give too much power to the government and make tax increases less visible to the public.<sup>169</sup> Others have expressed concerns that government-prepared returns may reduce overall tax compliance because taxpayers may be disinclined to report additional income that isn’t already reported on the pre-prepared return.<sup>170</sup>

Another relevant consideration is how the behavioral science research discussed in Part II can inform our understanding of how taxpayers would interact with a pre-prepared tax return. Individuals’ general preference for passivity seems to indicate that taxpayers would be inclined to accept a pre-prepared return as is without making modifications. For taxpayers with simple tax situations that are fully covered on a pre-prepared return, this probably doesn’t matter much from a revenue standpoint.<sup>171</sup>

It’s less clear what would happen when taxpayers were confronted with a partially pre-prepared return that required them to input additional income and/or deductions.

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the overwhelming majority of those that do use ReadyReturn are pleased with it. *See* STATE OF CAL., FRANCHISE TAX BD., TAXPAYERS’ BILL OF RIGHTS ANNUAL REPORT TO THE LEGISLATURE 8 (2013), [https://www.ftb.ca.gov/aboutFTB/taxpayer\\_advocate/2013\\_BillRightsAnnRpt.pdf](https://www.ftb.ca.gov/aboutFTB/taxpayer_advocate/2013_BillRightsAnnRpt.pdf) [<https://perma.cc/888K-FH22>] (reporting that over ninety-eight percent of users are “satisfied” or “very satisfied”); *see also* Bankman, *supra* note 152, at 784–85. Further, the low participation rates of the California system probably understate the potential participation rates of a similar federal system, because taxpayers likely make state return choices based off of how they file their federal return. *See* Bankman, *supra* note 152, at 785.

167. *See, e.g.,* ZELENAK, *supra* note 11, at 123 (arguing that tax agency reconciliation “might restore the virtues of a return-based income tax as an exercise in participatory democracy”); Bankman, *supra* note 152, at 787.

168. *See, e.g.,* ZELENAK, *supra* note 11, at 4; Bankman, *supra* note 152, at 787.

169. *See, e.g.,* Grover Norquist, President, Ams. for Tax Reform, *Implementing a “Return Free” Tax Filing Scheme: Presentation to the President’s Advisory Panel on Federal Tax Reform* (2005) (unpublished presentation), [http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/norquist\\_05172005.ppt](http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/norquist_05172005.ppt) [<https://perma.cc/5ME2-54XS>]. While Norquist fears that government-prepared returns would allow the IRS to overstate taxpayers’ liability, Bankman argues that it is more likely that government-prepared returns would *understate* tax liability overall because they would not include income that is not reported by third parties. *See* Bankman, *supra* note 152, at 786.

170. *See, e.g.,* Joann M. Weiner, *Panelists Weigh Pros and Cons of Federal Ready Return Program*, 119 TAX NOTES 1133 (2008). Bankman argues that this shouldn’t cause a substantial decrease in compliance, because taxpayers often fail to report income that is not subject to third-party reporting anyway. *See* Bankman, *supra* note 152, at 786–87.

171. If all of the taxpayer’s income and deductions were reported to the IRS by third parties, then presumably the returns would be accurate in most cases. Even if there were inaccuracies in some returns, it’s not clear that taxable income would be understated any more than it was overstated.

Consider, for example, a taxpayer with \$10,000 of independent contractor income that was not subject to third-party reporting. Assume he also earns wage and interest income each year and claims the standard deduction. When reviewing his tax return, the wage income and interest income would already be entered on the appropriate lines, as would the standard deduction. However, he would have to voluntarily add the \$10,000 of additional income to the return.<sup>172</sup> He could be prompted to do this in any number of ways: he might be presented with a statement informing him that he has to report additional income not already on the return, he might be prompted to check *yes* or *no* in response to a question about whether or not he has additional income to report, or he might simply be instructed to sign the return unless he has additions to make or needs to correct errors.<sup>173</sup>

The relevant question here is not merely whether the taxpayer would voluntarily report the \$10,000 income, but whether he is more or less likely to report it in the pre-prepared return scenario as compared to the current system. At present, many taxpayers fail to report income that is not reported by third parties.<sup>174</sup> It is possible that those honest taxpayers who would report the income under today's filing system would similarly report it on a pre-prepared return, and vice versa. Or, it's possible that, by making tax filing more passive overall, taxpayers will be less likely to actively volunteer that they have unreported income, particularly if they could do something as simple as check a box that says they agree with their return as pre-prepared.<sup>175</sup> If the latter scenario is accurate, pre-prepared returns could have a negative impact on overall tax compliance.

In any event, even if there is no clear revenue impact, taxpayer passivity probably does matter from a fiscal citizenship perspective. If a goal of simplified tax returns is to promote tax consciousness and fiscal citizenship by connecting taxpayers with the filing process in a more positive way, this benefit may not be recognized if taxpayers are mindlessly accepting pre-prepared returns with little or no conscious involvement. This appears to be a likely scenario for at least some taxpayers in light of the behavioral studies described above. Because our tendency for passivity will likely encourage many taxpayers to virtually ignore their pre-prepared returns, a more active approach to return preparation is desirable.

#### b. Taxpayer-Prepared Returns Linked to Taxpayer Accounts

A better option is to continue to require taxpayers (or their tax return preparer)<sup>176</sup> to prepare their tax returns, but to rely on the data in the taxpayer's online account to

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172. This is assuming that the federal program would apply more broadly than the ReadyReturn program, which is limited to taxpayers that have wage income *only*. Conditioning the use of pre-prepared returns on wage income, or income subject to third-party reporting, might discourage reporting of other types of income for taxpayers who earned unreported income but want to use pre-prepared returns.

173. The last option would probably encourage the most passive response. For sample text, see Bankman, *supra* note 152, at 782–83.

174. See *supra* note 127 and accompanying text.

175. Cf. Bankman et al., *supra* note 164, at 5–6 (suggesting that forcing taxpayers to lie by commission rather than omission might reduce evasion).

176. Tax return preparers are discussed further below in Part IV.D.1.

make the process significantly less burdensome. The taxpayer's personal account should have an easily accessible link for "Prepare Tax Return." Taxpayers should be able to stop work on the return at any time and return to find their work saved when they log back into their account.

The first step in preparing their electronic return should be a page that allows taxpayers to review their personal information (automatically imported from their taxpayer account), such as marital status and number of dependents. If the information is correct, it would be automatically entered onto the return once the taxpayer checks a box verifying its accuracy. If it is incorrect, taxpayers should be given the option to update it and have their corrected version automatically transferred to the return.

Next, the taxpayer should be guided through all of the third-party data that has been posted to her account.<sup>177</sup> For each form (e.g., Form 1099), a taxpayer should have the option to review the data and be presented with two options. One option would be to click a button that said something like "This is not correct," which would take her to a help page that would allow her to electronically communicate about the error with either the IRS or the reporting third party (or both). The second option, which would presumably apply in most cases (where there was no error), would be to click something to the effect of "Export to tax return." The account data would then automatically be added to the relevant line on the tax return and combined with any additional data (e.g., interest amounts would automatically be added together). By requiring each piece of data to be individually exported, taxpayers would be encouraged to consider all of the income and deductions being transferred to their tax returns, making them less likely to mentally disengage. However, by allowing them to view it online and export it with one simple click, the process would be considerably easier and less time-consuming.

Many taxpayers—those whose income and deductions are covered by third-party reporting and/or the standard deduction—would be finished at this point. For those with more complex tax situations or additional income to report, there are several options. Taxpayers could be prompted with a menu of different options that would allow them to manually choose which income or deductions they wanted to enter. Or taxpayers could be taken through a checklist where they select "yes" or "no" to a number of common additional sources of income and deductions.<sup>178</sup> The approach could be modeled off of that used by tax-preparation software companies, which generally allow taxpayers the option to be guided through the process or to select income and deduction items on their own.

Taxpayer passivity remains a concern when considering whether taxpayers would fail to report certain items of income on their return that were not already posted to

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177. Taxpayers should also be given the opportunity to review that third-party data independent of preparing their tax returns. For example, they might receive an email notification every time third-party data is posted to their account with a link that lets them access and review it.

178. Bankman, Nass, and Slemrod propose a "Smart Return," which would use data-driven interactive systems to tailor specific questions to individual taxpayers, the same way that a company like Amazon might tailor product recommendations to a customer. Bankman et al., *supra* note 164, at 18.

their taxpayer accounts.<sup>179</sup> One way to alleviate this might be to require, as part of the electronic tax-preparation process, taxpayers to affirmatively indicate that they do not have any additional sources of income by entering a “zero” when prompted.<sup>180</sup> While this extra step wouldn’t encourage all dishonest taxpayers to come clean, it would, at the very least, prevent not reporting the income from being the default position. At the same time, the tax-filing process would be less mentally burdensome overall, leaving taxpayers with more mental resources to expend on meeting their tax obligations.

#### 4. Tax Reporting on a Rolling Basis

Policy makers could further simplify taxpaying by allowing taxpayers to keep records and make midyear tax-return entries through their taxpayer accounts. This would help taxpayers organize their tax information in one place, easily keep track of it without fear of forgetting something, and reduce taxpayer time and effort at the end of the year when it was time to prepare a tax return. Consider charitable contributions, for example, which generally are deductible for itemizers<sup>181</sup> but currently are not subject to third-party information reporting. To deduct cash contributions, taxpayers must keep bank records, records of payroll deductions, or receipts<sup>182</sup> and then add their contributions together and report them on Schedule A to Form 1040 (Itemized Deductions).<sup>183</sup> Some taxpayers may find themselves scrambling to collect receipts or bank records at tax time and may find the process of claiming multiple deductions arduous and time-consuming.

A more convenient approach would be to allow taxpayers to log on to their tax account and enter each charitable donation as soon as they make it. They could click on a button that specifically links them to “Charitable Contributions” and be presented with a simple menu giving them options to “Enter a new donation” or “Get help” if they needed to view summaries of applicable rules.<sup>184</sup> “Enter a new donation” would link them to a page where they could input information about the charity and the amount donated. Taxpayers could be reminded with a brief statement that they

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179. IRS data on noncompliance suggests that taxpayers are far more likely to underreport income than they are to overstate deductions. *See* Thomas, *supra* note 101, at 128 n.109.

180. Similarly, some states require taxpayers to affirmatively report that they do not owe use tax.

181. Certain limitations apply but likely do not affect the majority of taxpayers. For example, deductions for contributions to charitable organizations like churches or schools are generally limited to fifty percent of the taxpayer’s adjusted gross income. I.R.C. § 170(b)(1)(A) (West Supp. 2016).

182. *See* INTERNAL REVENUE SERV., PUB. 526, CHARITABLE CONTRIBUTIONS 18–19 (2017). For cash contributions over \$250, the taxpayer must obtain a written acknowledgement from the charitable organization with specific information, such as whether the taxpayer received any goods or services in exchange for his contribution. *Id.* at 17–18. Additional rules apply for non-cash donations. *See id.* at 18–19.

183. Although tax-preparation software will do the math, taxpayers generally must input each charitable contribution separately at the time they file their tax return, which can be time-consuming if many donations have been made.

184. The “Get help” page could have a list of frequently asked questions that included information on things like how much to deduct for noncash contributions.

are required to keep their acknowledgement from the charity (or, for smaller donations, a bank record or check)<sup>185</sup> as evidence of their deduction. It should save information about charities donated to in prior years. When the taxpayer is preparing her return at year-end, she should be able to view the donations she entered during the year and have a simple option to export the information automatically to her return.<sup>186</sup>

Taxpayers should have the option to enter other deductible items into their tax accounts on a rolling basis as well. For example, certain deductible property taxes are not automatically reported to the IRS,<sup>187</sup> and taxpayers could be given the option to enter those payments in their account as they are made on a quarterly basis. They could also be given the option to report other deductible expenses like alimony or medical expenses as they are incurred during the year. These expenses could be stored in taxpayer accounts and accessible to review and export at year-end when taxpayers are preparing returns.<sup>188</sup>

Although making it easier for taxpayers to claim *deductions* may seem like a revenue loser at first glance, the point here is to simplify the entire process of tax preparation. Taxpayers are probably more motivated to expend mental effort to claim deductions (because deductions save them tax), but that mental effort is still depleting. Taxpayers who spend hours, for example, collecting records and inputting deductible items on their tax return may be less likely to report items of income honestly because they are mentally exhausted. Thus, there is merit to simplifying all aspects of taxpaying, including the process of claiming deductions.

Taxpayers should be able to record items of income on a rolling basis as well. This would be particularly helpful for independent contractors, for example, whose income might be reported at year-end on a Form 1099-K, but who might otherwise not pay taxes through withholding during the year. Such taxpayers could log into their taxpayer accounts and enter income at the end of each month, or each time they received a paycheck. They could also opt into a feature that would allow them to

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185. See *supra* note 182.

186. TurboTax offers a well-designed feature called “ItsDeductible” that allows taxpayers to track their deductions midyear and has recently rolled out a mobile app version of it. *ItsDeductible Online*, TURBOTAX, <https://turbotax.intuit.com/personal-taxes/itsdeductible/> [<https://perma.cc/PSW9-77QY>]. The service is free to download online but can only be imported onto the year-end tax return under the “Deluxe” package (starting at \$34.99) or one of the more expensive packages. See *Products & Pricing*, TURBOTAX, <https://turbotax.intuit.com/personal-taxes> [<https://perma.cc/T3Y6-C4L4>]. The IRS could rely on private companies to institute this feature or design their own version. This is discussed further below in Part IV.D.1.

187. Taxpayers with mortgages are likely to pay property taxes on their homes through escrow with the lending bank and will thus receive information about taxes paid from the bank (which will also report that information to the IRS). However, property owners that own their property outright are likely to pay property taxes directly to the local taxing authority and thus must keep their own records for federal tax deduction purposes. See Andrew T. Hayashi, *The Legal Salience of Taxation*, 81 U. CHI. L. REV. 1443, 1457 (2014).

188. Deductions for many expenses are limited under the tax laws by certain caps and/or floors. For example, medical expenses are only deductible to the extent they exceed ten percent of the taxpayer’s adjusted gross income. I.R.C. § 213(a) (2012). Currently, tax-preparation software programs calculate these limitations for the taxpayer, and the return-filing program linked to the taxpayer’s account could do the same thing. Tax-preparation software is discussed more below in Part IV.D.1.

receive an email reminder on a regular basis (e.g., once per month) to record their income. Not only would this help taxpayers keep and locate records of income that would be available at the time they prepared their year-end tax return, it would also help those taxpayers who must pay quarterly estimated taxes. For example, taxpayers might be able to click an “Estimated taxes” button after they report certain types of income that brings them to a page that would help them estimate the amount they must pay at the end of each quarter,<sup>189</sup> and a link that would allow them to make the payment directly from the website.

Allowing taxpayers to report items of income and deduction through taxpayer accounts on a rolling basis would make taxpaying more user-friendly for several reasons. First, it would break the process of tax reporting into very small steps spread out over time. This should make reporting less mentally depleting than sifting through various items of income and deductions and making entries in one sitting, whether the taxpayer does it by hand or with tax-preparation software. Additionally, recording items within a short time frame will help forgetful taxpayers remember what they spent or earned, and this could be bolstered with email reminders if the taxpayer so elects. This might also alleviate any anxiety taxpayers may experience over losing records or potentially forgetting a relevant transaction.<sup>190</sup> Further, doing much of the legwork of return preparation in advance should make the overall year-end tax preparation significantly easier and faster. If taxpayers have to spend fewer mental resources gathering deductions, for example, they will retain more energy to focus on any remaining matters that haven’t already been dealt with through their taxpayer accounts.

### 5. Make Low Compliance Areas User-Friendly

Finally, policy makers could identify areas that have particularly low compliance rates and design web tools that are specifically geared at making the compliance process as easy as possible. The IRS could follow the lead of experts in marketing and website design to encourage voluntary tax compliance using techniques similar to those employed to encourage consumers to purchase a product or use a website.

#### a. Nanny Taxes

As a case study, consider a hypothetical taxpayer who hires a nanny to care for his children after school at a salary of \$100/week. Assume our taxpayer knows of the “nanny tax” but has never paid it and is unsure of what is required.<sup>191</sup> Household

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189. The amount of the payment could be based off of last year’s tax liability or the current year’s earnings. *See generally* I.R.C. § 6654 (2010) (estimated tax required to avoid penalties).

190. Another self-employed taxpayer told me that he keeps boxes of paper receipts, which creates a burdensome and time-consuming process at tax time of claiming expenses. However, he said that the reason he no longer uses a software program to log his expenses is because he had a hard drive failure that caused him to lose a large amount of data that wasn’t backed up. Items of income and expense logged into online taxpayer accounts could be automatically backed up and could alleviate taxpayer concerns about losing their records.

191. Taxpayers generally must pay social security, Medicare, and federal unemployment taxes for household employees like babysitters who are paid at least \$2000 per year or \$1000

employees like nannies are frequently not reported for tax purposes,<sup>192</sup> and whether or not this taxpayer decides to comply may depend, in part, on how much trouble he thinks it will be. To investigate, he may begin with a simple Google search of something like *nanny tax* or *tax on babysitter*. Either search will bring up a slew of blog posts and articles discussing taxes on household employees, as well as several websites for private companies that offer assistance both searching for childcare and planning for childcare taxes for a fee.<sup>193</sup> A search for *nanny tax* will also bring up an IRS publication on household employees, although the taxpayer would have to scroll down the page past several other results to reach it.<sup>194</sup>

Assume our taxpayer searched for *nanny tax* and then clicked on the first link in the search results, which is a page entitled *Nanny Tax 101* on the website Care.com (a website where parents can find childcare providers and childcare providers can advertise their services).<sup>195</sup> The site provides a summary of what kinds of workers are taxable household employees and a short description of what taxes need to be paid and what forms need to be filed.<sup>196</sup> The site does not provide the user with links to any of the relevant forms and is presumably geared at encouraging customers to utilize Care.com's fee-based payroll services rather than making the process of paying household employee taxes easy.<sup>197</sup> At this point, our taxpayer may decide it's worth the \$1020 fee to enroll in Care.com's program, which will essentially manage the employment taxes for him.<sup>198</sup> But he may think this is too expensive and wish to handle the tax obligations himself.<sup>199</sup> If he relies on the summary description on Care.com to provide him with information about the steps he must take, he must then go search and track down each of the relevant tax forms from the IRS. He would also

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in one quarter (along with possible state unemployment taxes). INTERNAL REVENUE SERV., DEP'T OF TREAS., PUB. 926, HOUSEHOLD EMPLOYER'S TAX GUIDE 4 tbl.1 (2017) [hereinafter PUBLICATION 926]; see I.R.C. §§ 3111, 3301 (West 2011 & Supp. 2016). Whether a household worker is a taxable "employee" depends on a number of factors including, but not limited to, the amount paid for the services, the period of time spent working during the year, and the amount of control the employer has over the worker's services. See INTERNAL REVENUE SERV., *supra*, at 3.

192. See I.R.S. Notice 2007-35, 2007-1 C.B. 940, 940-41 ("Common Mistakes on Tax Returns").

193. See, e.g., CARE.COM, <https://www.care.com>; SITTERCITY, <https://www.sittercity.com> [<https://perma.cc/7N4T-67DG>].

194. The phrase *nanny tax* generates over 300,000 results on Google. The sixth result (including two paid advertisements) is IRS Publication 926. Nothing from the IRS or the government comes up on the first page of a search for *tax on babysitter*.

195. Tom Breedlove, *Nanny Tax 101*, CARE.COM, <https://www.care.com/homepay/nanny-tax-guide> [<https://perma.cc/YN28-GDG7>]. Care.com also offers a payroll service for its customers that takes care of things like paystubs and filing and collecting applicable federal and state employment taxes. The service costs \$205 per quarter, plus \$100 for year-end filing and \$100 for initial setup. *Service FAQs*, CARE.COM HOMEPAY, <https://www.care.com/homepay/service-faqs-1402251530> [<https://perma.cc/L9A9-6AUG>].

196. Breedlove, *supra* note 195.

197. However, the site does provide two links to IRS descriptions of determining whether a household worker is an employee and applying for an employer identification number. *Id.*

198. See *supra* note 195. The taxpayer may also decide to turn to a paid tax-return preparer at this point for help.

199. Or he may decide at this point not to report his nanny at all.



likely need more information about which forms to file, how much tax to pay, and what else is required.

After perusing private websites, or in lieu thereof, our taxpayer might turn to the IRS for more detailed help. A search for *nanny tax* on the IRS website or a Google search for *nanny tax IRS* both lead the taxpayer to several IRS publications, including Publication 926, *Household Employer's Tax Guide*.<sup>200</sup> Publication 926 is a dense, seventeen-page document with information about taxpayers' employment tax obligations, including the applicable dollar thresholds, rates, forms, and deadlines. A taxpayer unfamiliar with the rules would likely need to spend hours digesting its contents. If our taxpayer makes it to page four,<sup>201</sup> he would find a checklist at the bottom of various steps that must be taken to comply with the accompanying deadlines. He could presumably go back to the IRS website for each item on the checklist and download the relevant forms. He could also figure out the amount of employment tax he will owe by reading through the rules and doing the calculations manually. Combining all of these steps would be time-consuming and burdensome. If our taxpayer were already on the fence about whether to report the nanny, he may give up somewhere during this process and decide it's too much work. Further, reading through long descriptions of technical rules and searching for forms would likely be mentally depleting, making our taxpayer less prone to comply.

There is much that could be done to make the process of reporting a household worker like a nanny more user-friendly. First, a Google (or other search engine) search of *nanny tax* or similar terms should send the taxpayer directly to an IRS page.<sup>202</sup> The page should be designed as a one-stop shop where taxpayers can access all information and forms needed to comply with tax obligations relating to a household worker like a nanny. Taxpayers should also be able to access the page from their taxpayer accounts. For example, when entering information about dependents, the taxpayer account may prompt taxpayers to answer questions about childcare and provide links to related pages.

The website itself should be designed using principles like those identified by experts in marketing and web design discussed above in Part IV.A. For example, given the propensity of users to scan, rather than read, and to ignore instructions, the most essential information should be bolded or highlighted. To minimize noise, detailed information that would be relevant to only a minority of taxpayers should be left off the page altogether and accessible through a separate link.<sup>203</sup> Rather than

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200. PUBLICATION 926, *supra* note 191.

201. *Id.* at 4 tbl.2. This assumes the taxpayer is able to track down the pdf version of Publication 926. The first Google or IRS search results take the user to an html version of the publication, which is in small font and difficult to read. *Publication 926 - Main Content*, IRS (2017), <https://www.irs.gov/publications/p926/ar02.html> [<https://perma.cc/5LZX-95MV>].

202. If one searches for *enroll in healthcare* or even just *health care* (but not *healthcare*) on Google, the first result is Healthcare.gov. Presumably, the IRS could redesign certain pages on their website to accomplish the same result. See generally GOOGLE, SEARCH ENGINE OPTIMIZATION STARTER GUIDE (2010), <http://static.googleusercontent.com/media/www.google.com/en/us/webmasters/docs/search-engine-optimization-starter-guide.pdf> [<https://perma.cc/6D26-PF75>].

203. For example, Publication 926 contains a section called "How Can You Correct Schedule H?" for taxpayers who have made reporting errors. PUBLICATION 926, *supra* note

forcing taxpayers to begin by reading summaries of rules, they might instead be navigated through a checklist of questions requiring simple clicks.<sup>204</sup> For example, the site might first present the taxpayer with a question such as: “Do I Have a Household Employee?” and allow them to read a short bulleted description under the “Yes” and “No” options. The next step might ask the taxpayer to estimate how much they will be paid a week to determine whether the applicable dollar thresholds for employment taxes are met, and so on.

Once it is determined that the taxpayer does have a taxable household employee, they could be presented with a checklist of obligations similar to that provided by Publication 926.<sup>205</sup> However, the checklist should automatically link the taxpayer to an online version of each form needed, with an option to file it electronically.<sup>206</sup> It should also contain an online calculator that would automatically calculate the employment tax due by both the employer and employee (once the taxpayer inputs information like salary). Taxpayers should be given the option to make online payments as well, with a direct debit feature if they so elect. Ideally, the taxpayer would be able to save and store all of the relevant forms and records in his taxpayer account.

#### b. Self-Employed Taxpayers

The IRS should also pursue simplification measures that are particularly aimed at self-employed taxpayers, who face high procedural complexity because their income is generally not subject to withholding and information reporting. Online services offered by private banks may serve as a good model here. For example, many private banks offer customers a service that allows them to deposit checks into their personal checking accounts from home by taking a photo of the check with a tablet or cell phone; the bank’s software automatically uploads the information. The IRS could

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191, at 12–13. Rather than supplying all of this information on the website, there could be a clickable button or link that says “Made an Error?” that would lead the taxpayer to the relevant information. Access to the detailed rules in Publication 926 could be provided through links multiple times on the website.

204. See, e.g., *supra* note 110 and accompanying text. Of course, not all tax rules can be boiled down to a few simple bullets. The key would be to provide only information that is relevant to *most* taxpayers, with links to access further information applicable to particular situations. Further, some rules could be summarized on a very high level on the website but explained in more detail elsewhere for taxpayers who wanted more information. For example, rather than providing a taxpayer with descriptions of dollar thresholds (e.g., minimum salary of \$2000 per year for employment taxes and social security maxing out at \$127,200 per year, PUBLICATION 926, *supra* note 191, at 6), a taxpayer could simply enter in the expected annual salary on the website and be presented with the amount of tax that applies to her specific situation. Taxpayers who want to know the threshold levels for planning purposes might be able to click a link that says something like “Dollar thresholds for employment taxes.”

205. Those obligations include verifying the employee’s citizenship, obtaining an employer identification number, providing a Form W-2 to the employee, and filing Schedule H to Form 1040. PUBLICATION 926, *supra* note 191, at 4 tbl.2.

206. The Social Security Administration (SSA) website already provides electronic filing for Form W-2. *Employer W-2 Filing Instructions & Information*, SOC. SECURITY, <https://www.ssa.gov/employer/> [<https://perma.cc/EU7S-EMGD>]. However, a taxpayer searching the IRS website for this information will not be linked to the SSA website.

offer similar services to self-employed taxpayers to help them easily record income and expenses. Taxpayers could, for example, take pictures of invoices and receipts with their cellphones with an app, categorize the item by selecting from a menu of options, and then have the data automatically saved in their taxpayer accounts.<sup>207</sup> The app might also have a “cash” feature that would allow the taxpayer to quickly log in something like a cash tip by typing in the amount on their cell phone. The expenses and income items would be reviewable at any time and not exported to the tax return until the taxpayer later chose to do so. Because the data would already be in their accounts, taxpayers should save significant time and effort when preparing their returns at year-end.<sup>208</sup> Taxpayers who might otherwise not report income because of sloppy record keeping may report more accurately. Additionally, by making accurate reporting *easier*, the service should encourage more honest reporting.

These are just some examples of the many areas where the IRS could redesign the compliance process to be simpler and less burdensome. To encourage the use of new products and tools, the IRS might incentivize taxpayers by providing small tax rebates. The Determined Cheaters, who are committed to underreporting, are unlikely to be swayed by simplification. But making the process easier may encourage a number of reluctant Taxpayers On The Fence to comply.

#### *D. Potential Issues and Objections*

Critics may object to these proposals on a number of grounds, including that they may be costly with only speculative benefits. Others might argue that it is unnecessary for the IRS to make the taxpaying process easier for taxpayers in light of the prevalence of tax-return preparers and tax-preparation software. Finally, some might object to procedural simplification on theoretical grounds, arguing that it will undermine taxpayers’ substantive understanding of the tax laws. This Part addresses some of those concerns.

##### *1. Does Procedural Simplification Lack a Constituency?*

When considering measures like redesigning the IRS website or instituting taxpayer accounts, an important question to consider is whether there are a significant number of taxpayers who would benefit from these changes.

###### *a. Tax Return Preparers*

Critics might argue, for example, that the prevalence of paid tax return preparers makes some of these policy proposals irrelevant. But there are several reasons why the use of tax-return preparers does not detract from the importance of making the

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207. Private companies, such as Shoeboxed.com, offer similar mobile record keeping services (to “scan [and] organize receipts”) ranging from \$120 to \$1200/year. SHOEBOXED.COM, <https://www.shoeboxed.com/> [https://perma.cc/92NZ-V5LQ]; *Scalable Plans & Pricing*, SHOEBOXED.COM, <https://www.shoeboxed.com/pricing/> [https://perma.cc/SH7B-RGXF].

208. Storing income and expense information electronically would also ensure the information was backed up and wouldn’t be lost.

system more user-friendly for taxpayers. First, over forty percent of taxpayers currently prepare their own taxes.<sup>209</sup> Simplification would impact these tens of millions<sup>210</sup> of taxpayers directly and improve compliance.

Second, more taxpayers might self-prepare if the process were easier. And while the use of tax-return preparers is likely beneficial from a compliance perspective for some taxpayers,<sup>211</sup> there could be benefits to encouraging taxpayers with relatively uncomplicated tax situations (e.g., wage earners who claim the standard deduction or itemize few deductions) to self-prepare. Self-preparing would save taxpayers the cost of paying preparation fees<sup>212</sup> and would also likely cut down on certain inefficiencies such as duplicated efforts between the taxpayer and the preparer. Additionally, empowering taxpayers to self-prepare by making the process easier (and cheaper) may engender more positive feelings about the tax system overall, which could also have a positive impact on voluntary tax compliance.

Third, procedural simplification has merit even for those taxpayers who would continue to use a tax-return preparer. Those taxpayers still have to spend time and mental energy doing things like keeping records and collecting forms at the end of the year. There is still a risk that taxpayers who are overwhelmed by procedural complexity may not comply with their obligations, for example, by not giving relevant information to their preparers. Thus, measures like data retrieval and taxpayer accounts could be hugely beneficial even for taxpayers who were not going to actually prepare their tax return. Additionally, taxpayers could have an option to authorize a tax professional to have access to their tax account to file their return and do things like communicate with the IRS or receive notices on their behalf.<sup>213</sup> Allowing tax professionals to share in the benefits of things like data retrieval and

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209. For the tax year 2010, 40.78% of tax returns (approximately 56.7 million returns) were self-prepared. The percentages are similar for 2009 and for the first quarter of 2011. See INTERNAL REVENUE SERV., DEP'T OF TREAS., PUB. 4822, TAXPAYER FILING ATTRIBUTE REPORT (2013), <http://www.irs.gov/pub/irs-pdf/p4822.pdf> [<https://perma.cc/D6CA-QV6G>]. The IRS has said more recently that the number of taxpayers electronically self-preparing is rising. *More Taxpayers Filing from Home Computers in 2014*, IRS (Mar. 13, 2014) [hereinafter *More Taxpayers Filing*], <http://www.irs.gov/uac/Newsroom/More-Taxpayers-Filing-from-Home-Computers-in-2014--Many-Taxpayers-Eligible-to-Use-Free-File> [<https://perma.cc/J42U-SXEF>] (increase from forty-two percent to forty-four percent of electronic filers from 2013 to 2014).

210. See INTERNAL REVENUE SERV., *supra* note 209.

211. The use of tax-return preparers might enhance compliance if individuals are more likely to be honest when a third party is involved. Additionally, compliance may be improved when preparers can help taxpayers understand the substance of their tax obligations. For example, an accountant might inform a taxpayer that an item of income is reportable that the taxpayer wouldn't have otherwise known to report. Of course, taxpayers who use preparers might report less income overall if preparers help them claim more deductions and credits than they otherwise would or if their preparers encourage them to take aggressive tax positions.

212. There are fees for tax-preparation software like TurboTax, but they are generally lower than paying a professional to prepare your return. See, e.g., Sandra Block, *More Taxpayers Are Preparing Their Taxes on Their Own*, USA TODAY (Apr. 14, 2010, 10:32 AM), [http://usatoday30.usatoday.com/money/perfi/taxes/2010-04-14-1Ataxprep14\\_CV\\_N.htm](http://usatoday30.usatoday.com/money/perfi/taxes/2010-04-14-1Ataxprep14_CV_N.htm) [<https://perma.cc/82DK-ULJV>].

213. This was recommended by the ETAAC in their 2014 Report to Congress. ELEC. TAX ADMIN. ADVISORY COMM., *supra* note 137, at 31.

online accounts would simplify the system for the professionals, the taxpayers, and the IRS.

b. Tax-Preparation Software and E-Filing

Another issue to consider is whether tax-preparation software already accomplishes the simplification goals discussed here. Currently, about one-third of taxpayers use tax-preparation software to self-prepare their tax returns.<sup>214</sup> Although lower income taxpayers (currently, those with annual income below \$64,000) are eligible for free access to tax-preparation software,<sup>215</sup> other taxpayers must pay fees starting from \$55 to \$115 depending on the complexity of their tax situations, and increasing with each state return filed.<sup>216</sup> For taxpayers who self-prepare online, tax-preparation software undoubtedly simplifies the process and makes filing less burdensome. For example, taxpayers can save and review prior year returns, carry over relevant information to future years, and click through questionnaires to help them determine which tax rules apply to them. Software programs will also handle calculations and automatically apply rules like deduction phaseouts for the taxpayer.

So what does the government's involvement add here? First, the simplification proposals discussed above could be considered in conjunction with, not in lieu of, the use of commercial tax-preparation software. An essential component of taxpayer accounts would be access to online self-preparation services similar to what is currently offered from private software companies. To integrate online taxpayer accounts with tax return preparation, the government could develop its own preparation software program that it could offer free of charge to all taxpayers.<sup>217</sup> Or, if it is deemed more cost-effective to continue to partner with private software companies, taxpayers could be directed to the private tax-preparation company of their choice from their taxpayer account, similar to the way low-income taxpayers can currently select free,

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214. See *Protecting Taxpayers from Incompetent and Unethical Return Preparers: Hearing Before the S. Comm. On Finance*, 113th Cong. 131 (2014) (written testimony of John A. Koskinen, Comm'r, Internal Revenue Service) ("34 percent of taxpayers use tax preparation software . . .").

215. *Free File: Do Your Federal Taxes for Free*, IRS, <http://www.irs.gov/uac/Free-File:-Do-Your-Federal-Taxes-for-Free> [<https://perma.cc/A7DH-YF2S>] (last updated Mar. 10, 2017).

216. *Products & Pricing*, *supra* note 186. Although taxpayers above the income threshold have to pay for tax preparation software, all taxpayers can electronically file their returns for free with the IRS. For 2016 returns, TurboTax is offering free filing of all returns for taxpayers eligible to file a Form 1040EZ or 1040A. *Absolute Zero – TurboTax Federal Free Edition*, TURBOTAX, <https://turbotax.intuit.com/personal-taxes/online/free-edition.jsp> [<https://perma.cc/JTQ3-UUZU>].

217. This is the approach taken by the South African Revenue Service, which offers free online tax-preparation software to all taxpayers, as well as a mobile app for preparing one's tax return. SARS E-FILING, <http://www.sarsefiling.co.za/default.aspx> [<https://perma.cc/77H9-J4KY>]; *SARS eFiling App & Mobi-Site*, SARS, <http://www.sars.gov.za/ClientSegments/Tax-Practitioners/Pages/Smartphone-App.aspx> [<https://perma.cc/4FNA-38HS>]. I am grateful to Eric Zolt for bringing this to my attention.

private online preparation services from the IRS website.<sup>218</sup> Some specialized services could still be offered for a fee, but all taxpayers should be able to self-prepare and e-file their tax return free of charge.<sup>219</sup>

By offering online tax-preparation services free of cost, more taxpayers will be motivated to use them, which should improve compliance. But there is also a diversity of interests among the government and private software companies that further justifies the government's involvement here. Although private companies have greatly simplified many aspects of tax compliance, their ultimate goal is to create taxpayer reliance on the company's fee-based services. The goal of the government, on the other hand, should be to empower taxpayers to successfully manage their tax affairs at the lowest cost possible.<sup>220</sup> For many taxpayers (with simpler tax situations), the goal would be to enable them to easily manage their tax affairs with little or no paid assistance.<sup>221</sup> Not only would this reduce compliance costs for taxpayers, but the government's involvement in simplification could also have a powerful signaling effect. Taxpayers who perceive that the IRS is trying to make their lives easier may view paying taxes in a more positive light, which could further enhance voluntary compliance.

The simplification proposals discussed here could also improve the process for those taxpayers who are already using tax-preparation software, even if the IRS chose to partner with those same private software companies. For example, the IRS could partner with companies like TurboTax to ensure that third-party data (e.g., 1099s) posted to taxpayer accounts could automatically be imported onto tax returns, thus

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218. Currently, the free online tax-preparation services available to low-income taxpayers are offered through a partnership between the IRS and the "Free File Alliance," a group of private software companies. *Free File: About the Free File Alliance*, IRS, <http://www.irs.gov/uac/About-the-Free-File-Alliance> [<https://perma.cc/Q6M9-N3P7>] (last updated Dec. 2, 2016). For a general discussion of the costs and benefits of outsourcing tax administration to the private sector, see Richard M. Bird & Eric M. Zolt, *Technology and Taxation in Developing Countries: From Hand to Mouse*, 61 NAT'L TAX J. 791, 812–14 (2008).

219. There is a question, of course, of who would bear the cost of providing free tax-preparation software to taxpayers who are currently ineligible to receive it. The software companies (like TurboTax) that are part of the Free File Alliance, *see supra* note 218, presumably found it beneficial to offer free tax preparation to those with incomes under \$64,000. In this case, the IRS would also be presenting taxpayers with an "alliance" of software companies that the taxpayer could link to directly from their taxpayer account. It's possible that, if the IRS required free basic tax-preparation services for all taxpayers as a condition to being a member of that alliance, software companies would oblige. It might be worth it to them if they could advertise and offer paid products that would reach a larger audience by virtue of their association with taxpayer accounts. Alternatively, the private software companies might be able to generate revenue from free tax-preparation services if they could sell online advertisements that would appear during the course of the return preparation process.

220. Evidence of this conflict of interest can be seen in Intuit's (the maker of TurboTax) fierce lobby against the California ReadyReturn and other proposed "simple return" measures. *See supra* notes 163, 165, and accompanying text.

221. Given the potential conflict of interest, it might make sense for the government to offer some (if not all) services directly. For example, even if the IRS relied on software companies for return preparation, it might offer cell phone and tablet applications (like one that would allow taxpayers to photograph receipts and invoices) directly.

saving taxpayers the procedural headache of accounting for and inputting data from various information returns when they self-prepare. Additionally, the IRS could encourage software preparation companies to allow rolling return entries to be made midyear to further simplify the process for taxpayers.<sup>222</sup>

Further, the simplification proposals in this Article go beyond the tax return preparation process and thus apply beyond the reach of tax software companies. Measures like increasing information reporting or redesigning the IRS website to simplify recordkeeping for household employees will simplify taxpaying for individuals regardless of whether they use tax return preparation software.

### c. Taxpayers On The Fence

Finally, critics might argue that, while procedural simplification has efficiency advantages, it will not promote better tax compliance because taxpayers who have an opportunity to cheat (e.g., the self-employed) will do so regardless of how simple the process is. In other words, one might claim that most taxpayers are Determined Cheaters and that Taxpayers On The Fence do not make up a meaningful portion of the population. It's certainly true that taxpayers who earn income not subject to information reporting or withholding demonstrate low compliance rates, both in the percentage of income reported as a group (less than half) and the percentage of taxpayers who underreport to some degree (roughly sixty percent).<sup>223</sup> However, the IRS's compliance data also indicates that a significant portion of taxpayers in this group—about forty percent—do report all of their income accurately.<sup>224</sup> It should be stressed that this forty percent reports honestly notwithstanding very low audit rates (about three percent for the self-employed)<sup>225</sup> and correspondingly low expected penalties for evasion.

While the data supports the notion that a significant number of people are not Determined Cheaters, where does that leave Taxpayers On The Fence? IRS compliance statistics alone can't tell us which taxpayers will always report accurately or inaccurately (Honest Taxpayers and Determined Cheaters respectively) and which might be swayed in one direction or another depending on the circumstances. However, empirical studies showing that various behavioral interventions improve tax compliance lend support to the notion that some middle ground group of taxpayers must exist. For example, recent studies have shown that requiring individuals to sign a tax form at the top instead of the bottom results in better compliance;<sup>226</sup> other studies have shown that verbal appeals to conscience or letters invoking social norms

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222. Although software companies might not want to incur the costs of implementing such changes, the IRS could require it as a condition to membership in the group of software companies that would be linked to taxpayer accounts.

223. See WHITE, *supra* note 100, at 3, 10.

224. *Id.* at 10 (showing that about nine percent of these taxpayers overreported net income for the year under study).

225. *Id.* at 23.

226. See CABINET OFF. BEHAVIOURAL INSIGHTS TEAM, APPLYING BEHAVIOURAL INSIGHTS TO REDUCE FRAUD, ERROR AND DEBT 3 (2012), [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/60539/BIT\\_FraudErrorDebt\\_accessible.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/60539/BIT_FraudErrorDebt_accessible.pdf) [<https://perma.cc/9UQW-PZ4S>]; see also NAT'L SCI. AND TECH. COUNCIL, EXEC. OFF. OF THE PRESIDENT,

also improve tax compliance.<sup>227</sup> Because those behavioral interventions do not involve an increase in the odds of detection or the penalty for evasion, improvements in compliance must come from Taxpayers On The Fence.<sup>228</sup> While further study is certainly necessary to test whether procedural simplification itself would be an effective motivator among these taxpayers, similar studies of other behavioral interventions indicate that such research is worthwhile.

## 2. Is Procedural Simplification Cost-Effective?

Critics might also argue that the simplification measures proposed here would be too costly to implement. Simplification undoubtedly would impose costs on third parties (in the case of information reporting, for example) and on the government (to design and implement taxpayer accounts, for example). The question, however, is whether those costs would be outweighed by the benefits of simplification.

If simplifying the taxpaying process reduces mental depletion, then behavioral studies indicate that taxpayers would be more likely to behave honestly and less likely to behave passively, both of which should improve voluntary tax compliance and result in more tax revenue. Additionally, simplification could reduce taxpayer costs and enhance voluntary compliance in less direct ways. For example, it might reduce psychic costs like anxiety and frustration incurred by taxpayers in their

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SOCIAL AND BEHAVIORAL SCIENCES TEAM ANNUAL REPORT 15 (2015), <https://www.sbst.gov/download/2015%20SBST%20Annual%20Report.pdf> [<https://perma.cc/78SX-ZPAP>] (more fees collected when government vendors were required to e-sign at the top of an online payment form as opposed to the bottom); Lisa L. Shu, Nina Mazar, Francesca Gino, Dan Ariely & Max H. Bazerman, *Signing at the Beginning Makes Ethics Salient and Decreases Dishonest Self-Reports in Comparison to Signing at the End*, 109 PROC. NAT'L ACAD. SCI. 15197, 15198 (2012) (study of car insurance consumers reporting odometer mileage showed more miles reported when form signed at the top). The idea here is that signing a form at the beginning makes one's ethical standards more salient, which tends to lead to more honest behavior. See Kathleen DeLaney Thomas, *The Psychic Cost of Tax Evasion*, 56 B.C. L. REV. 617, 632–35 (2015).

227. See, e.g., Richard D. Schwartz & Sonya Orleans, *On Legal Sanctions*, 34 U. CHI. L. REV. 274 (1967). In a field experiment, taxpayers were interviewed prior to filing their returns and asked questions intended to highlight either ethics or sanctions. Researchers observed a significantly greater increase in compliance among those in the “appeals to conscience” group as compared to those in the sanctions group and control groups. *Id.* at 298–99; see also Michael Hallsworth, John A. List, Robert D. Metcalfe & Ivo Vlaev, *The Behavioralist as Tax Collector: Using Natural Field Experiments To Enhance Tax Compliance* 3–4 (Nat'l Bureau Econ. Res., Working Paper 20007, 2014), <http://www.nber.org/papers/w20007> [<https://perma.cc/HW2Q-HV3N>] (finding that letters containing descriptive norm statements, such as “[n]ine out of ten people pay their tax on time,” increased the likelihood that individuals would pay previously reported tax liabilities). Evidence on the effectiveness of appeals to social norms is mixed, however. Thomas, *supra* note 226, at 628–29. For an overview of empirical studies supporting various noneconomic theories of tax compliance, see Andreoni et al., *supra* note 3, at 850–52.

228. Recall that Determined Cheaters will evade as long as there is an opportunity to do so without economic consequences, so interventions that do not alter the perceived risk of detection or penalty for evasion would not impact their compliance decisions.



interactions with the tax system. Procedural simplification might also promote positive attitudes about taxpaying that could foster more voluntary compliance. Increased tax compliance and simplified tax reporting should reduce the costs to the government of tax collection and enforcement as well.

Some taxpayers (i.e., Determined Cheaters) undoubtedly will continue to evade tax, perhaps because they believe they are unlikely to get caught or because they harbor negative feelings about the tax system. However, heterogeneity among taxpayers does not mean that simplification measures aren't cost-effective. Increasing voluntary compliance among even a minority of taxpayers over many years could justify the upfront costs of simplification.

Procedural simplification should also reduce overall compliance costs for taxpayers, who collectively spend billions of hours each year attending to tax matters.<sup>229</sup> For example, having the ability to export electronic data posted to a taxpayer account to a tax return should reduce the time spent by taxpayers collecting various forms and inputting information into their tax returns. An economist's report on the "Simple Return" estimated that it would save 225 million hours of time and over two billion dollars in tax-preparation fees each year, with an overall reduction of compliance costs worth forty-four billion dollars over ten years.<sup>230</sup> The potentially massive reduction in time and other resources spent by taxpayers may alone justify the cost of procedural simplification measures, with enhanced voluntary compliance only adding further benefits to the fisc.

With respect to costs imposed on third parties, IRS data shows that requiring information reporting has a strong positive impact on tax compliance,<sup>231</sup> and the compliance benefit alone might outweigh the costs of expanding information reporting.<sup>232</sup> Additionally, automatic online reporting of income and deductions could reduce the social costs of tax compliance overall because large third parties (banks, for example) can likely compile that information more efficiently than individual taxpayers.

In terms of costs imposed on the government, the goal would again be for overall benefits to outweigh the associated costs of procedural simplification. Even weighing the implementation costs against increased tax revenues alone, the report on the simple return concludes that tax agency reconciliation filing "would have little cost and might even save the IRS money by reducing the error rate of filers."<sup>233</sup> And the benefits identified in the report—increased accuracy and reduction in overall taxpayer compliance costs—don't even take into account the added benefits of higher voluntary compliance rates and spillover effects like less taxpayer anxiety and frustration. All of these benefits combined would result in reduced social costs and increased tax revenue going forward, which should outweigh upfront costs associated with designing and implementing measures like taxpayer accounts or user-friendly web tools.

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229. See SLEMROD & BAKIJA, *supra* note 20, at 3–4.

230. GOOLSBEE, *supra* note 161, at 5. Even though this Article does not recommend tax agency reconciliation filing like the system proposed by Goolsbee, the cost-benefit analysis is comparable.

231. See *supra* note 2.

232. A separate hurdle, however, is that increasing information reporting would likely be politically unpopular among the affected industries.

233. GOOLSBEE, *supra* note 161, at 6.

Presumably, the same cost-benefit analysis led the IRS to undertake the My IRS Account project in 2006, and is the reason the ETAAC has continued to advocate for taxpayer accounts.

Critics might also argue that the enhanced voluntary compliance benefits identified in this Article are too tenuous. For example, they might claim that studies on mental depletion do not necessarily apply to taxpayer behavior, or that some taxpayers will continue to report dishonestly even if the process is made simpler. Further study certainly needs to be undertaken to understand the relationship between mental depletion and tax compliance behavior. Although one study has demonstrated tax complexity impacts whether taxpayers make choices that optimize income,<sup>234</sup> a similarly designed study might instead measure whether taxpayers honestly report income or deductions when confronted with a complex tax system. But the need for further research does not render simplification unworthy, but rather means that policy makers should proceed with caution. For example, rather than implementing simplification measures broadly, the government might conduct pilot programs of measures like taxpayer accounts to determine their impact on voluntary compliance.<sup>235</sup>

### 3. Does Procedural Simplification Undermine Tax Consciousness?

Finally, critics could argue that, at a certain point, procedural simplification might make things *too* easy. The result could be that managing our tax affairs becomes so mindless and automatic that it undermines our tax consciousness and detracts from the fiscal citizenship benefits of paying taxes.<sup>236</sup> For example, relying on computer software or online tools to make calculations may allow taxpayers to prepare their tax returns without understanding the substantive rules that apply to them.<sup>237</sup> Although tax-preparation software already poses this risk under our current system, the procedural simplification proposals discussed here could further exacerbate the problem.

However, as commentators have pointed out, tax complexity also undermines tax consciousness.<sup>238</sup> Taxpayers may feel disconnected from and resentful of the tax system if they do not understand the rules that apply to them and if they are mired in burdensome reporting and record keeping requirements. The relevant question, then, is how the procedural simplification proposals discussed here would impact the status quo: would procedural simplification further reduce tax consciousness or would it improve things?

Research on the human brain, mental depletion, and consumer behavior points

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234. *See supra* note 91.

235. The ReadyReturn program was similarly subjected to pilot testing. Bankman, *supra* note 152, at 783–85. For a discussion of potential laboratory and pilot testing of taxpayer behavior, see Thomas, *supra* note 226, at 659–61.

236. *See, e.g.* Ventry, *supra* note 152, at 847–49.

237. Lawrence Zelenak argues that the proliferation of tax-preparation software has enabled Congress to adopt more substantively complex tax legislation without resistance from taxpayers. The effect, he argues, is essentially a “black-box tax system,” which, he argues, undermines democracy. ZELENAK, *supra* note 11, at 113–114.

238. *Id.* at 113; Ventry, *supra* note 152, at 847–49.

towards a common theme: above almost everything else, we want things to be *easy*. Other virtues like fairness, democracy, and efficiency will be lost on taxpayers who decide to disengage with the tax system as much as possible because of the mental effort required. Studies showing that our mental resources are limited indicate that taxpayers will not even be able to appreciate the substance of the rules that apply to them if the process of learning those rules or otherwise complying with their obligations is too draining. Thus, simplifying the process of taxpaying is a necessity if we want to promote more tax consciousness. That's not to say that simplification will not continue to enable taxpayers to meet their obligations without a full understanding of the laws. But this may be the lesser of two evils: encouraging taxpayers to engage with the tax system by making things easier is surely preferable to a system that discourages engagement by requiring mental stamina to participate.

#### CONCLUSION

Improving voluntary tax compliance would generate much needed tax revenue for the government. One promising means of encouraging more individuals to voluntarily comply is to simplify the process of paying taxes. As things currently stand, our taxpaying obligations are mentally exhausting and collectively consume immense amounts of time and financial resources. Empirical studies show that, not only do we have a strong preference for simplicity in our daily lives, but mental exhaustion drives us to behave passively and makes us more likely to cheat. Improvements in technology over the past few decades present an opportunity to vastly simplify many aspects of taxpaying, for example, by allowing taxpayers to easily record, access, and report their income and deductions online. Easing the burden of taxpaying should encourage more taxpayers to report honestly. Additionally, a tax system that is more user-friendly would reduce compliance costs for taxpayers and enforcement costs for the government. At the same time, it could be an important step towards restoring positive attitudes about our civic duty to pay taxes.