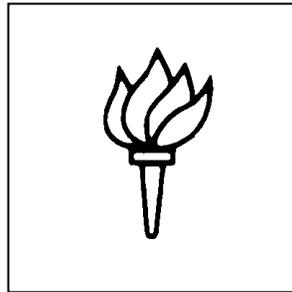


NEW YORK UNIVERSITY

SCHOOL OF LAW

PUBLIC LAW & LEGAL THEORY RESEARCH PAPER SERIES
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WORKING PAPER NO. 13-41



United States National Report on Tax Privacy

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November 2013

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1. Overview

1.1. Policy Issues

This National Report describes the current tax privacy protections that apply to taxpayers in the United States and provides an overview of the policy considerations that have contributed to their enactment. The debate over whether tax privacy promotes individual tax compliance in the United States is as old as the income tax itself.¹ In 1862, when Congress first instituted the income tax to pay for the Civil War, it required the names of taxpayers and their tax liabilities to be open to public inspection.² Since then, Congress has repealed,³ enacted,⁴ and repealed again⁵ similar measures, each time after vigorous discussion of the relationship between tax privacy and individual tax compliance. Today, tax privacy rules prohibit the US federal government from publicly releasing the details of any specific taxpayer's tax return or audit history unless the taxpayer consents.⁶ But debate over this question resurfaces often,⁷ especially when the government seeks innovative ways to address the "tax gap," or the difference between the amount of tax that taxpayers should pay and the amount that they actually pay voluntarily and on time, which was estimated at USD 345 billion annually in 2006.⁸

Defenders of tax privacy have long contended that it encourages individual tax compliance because, without it, taxpayers would limit the information that they disclose to the government. Because the individual tax return contains so much sensitive personal information, defenders of tax privacy suggest that taxpayers might feel vulnerable to embarrassment or harassment if others could view it.⁹ As a result, many defenders of tax privacy have speculated that individual taxpayers will

1 As Boris Bittker commented in 1981, this question "was not invented yesterday." Boris I. Bittker, *Federal Income Tax Returns—Confidentiality vs. Public Disclosure*, *Washburn L.J.* 20, 1981 479, 480–81.

2 Act of July 1, 1862, ch. 119, §§ 15, 19, 12 Stat. 432, 437, 439 (repealed 1870). Congress actually passed the first income tax in 1861, though it went into effect in January 1862 and was repealed later that year before any taxes were collected. Act of Aug. 5, 1861, ch. 45, § 49, 12 Stat. 292, 309 (repealed 1862).

3 Act of July 14, 1870, ch. 255, § 11, 16 Stat. 256, 259.

4 Revenue Act of 1934, ch. 277, § 55(b), 48 Stat. 680, 698 (repealed 1935).

5 Act of Apr. 19, 1935, ch. 74, 49 Stat. 158, 158–59.

6 I.R.C. §§ 6103(a), (b)(2), (c) (2006).

7 See, e.g., Anna Bernasek, *Should Tax Bills Be Public Information?*, *N.Y. Times*, Feb. 14, 2010, at BU11.

8 Office of Tax Pol'y, U.S. Dep't of the Treasury, *A Comprehensive Strategy for Reducing the Tax Gap* 5–6 (2006).

9 See, e.g., 79 Cong. Rec. 2594 (1935) (statement of Rep. Alfred Beiter).

comply with the tax system only if they trust that their personal tax information “stops with the government.”¹⁰

The contemporary tax-compliance literature, however, reveals palpable scepticism toward the taxpayer-trust theory of tax privacy. Many scholars have questioned the hypothesis that, in the absence of tax privacy, individuals would withhold important personal information from the IRS.¹¹ Several of these scholars have suggested that tax privacy no longer plays as critical a role in fostering tax compliance as it did in the past.¹² By lifting the curtain of tax privacy, these scholars argue that public access to tax return information would cast “[m]illions of eyes”¹³ on tax returns, serving as an “automatic enforcement device.”¹⁴

For over 150 years, the tax privacy debate has followed familiar patterns. Because neither side has offered a convincing prediction of taxpayers’ reactions to the threat of public disclosure of their tax returns, the question of whether tax privacy promotes individual tax compliance has swung back and forth between these two sides. Both sides have fixated on the question of how a taxpayer would comply with the tax system if she knew other taxpayers could see her personal tax return. Neither side, however, has addressed the converse question: How would seeing *other* taxpayers’ returns affect whether a taxpayer complies?

This Report probes that unexplored question and, in doing so, offers a new defence of individual tax privacy: that tax privacy enables the government to influence individuals’ perceptions of its tax-enforcement capabilities by publicizing

10 *Office of Tax Policy, Dep’t of the Treasury, Report to the Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions* 1, 2000, 19 (attributing the quote to Andrew Mellon).

11 See, e.g., Marjorie E. Kornhauser, *Doing the Full Monty: Will Publicizing Tax Information Increase Compliance?*, *Can. J.L. & Jurisprudence* 18, 2005, 95, 113 (proposing the enactment of a modern-day “pink slip” statute for the public disclosure of some tax information); Marc Linder, *Tax Glasnost’ for Millionaires: Peeking Behind the Veil of Ignorance Along the Publicity–Privacy Continuum*, *N.Y.U. Rev. L. & Soc. Change* 18, 1990, 951 (proposing the publication of millionaires’ tax returns); Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, *U. Kan. L. Rev.* 51, 2003, 1065, 1120–43 (proposing additional disclosure exceptions to I.R.C. § 6103); Paul Schwartz, *The Future of Tax Privacy*, *Nat’l Tax J.* 61, 2008, 883, 895–96 (arguing that, due to the wide availability of information about individuals, tax privacy laws’ effects are generally reduced); Joseph J. Thorndike, *Show Us the Money*, *Tax Notes* 123, 2009, 148, 148–49 (arguing for public access to individual taxpayers’ tax returns); Joseph J. Thorndike, *The Thorndike Challenge*, *Tax Notes* 122, 2009, 691, 691–92 (arguing for the release of politicians’ tax returns); Bernasek, *supra* note 7 (quoting Professor Laurence J. Kotlikoff as saying that “[d]isclosure could be an automatic enforcement device”).

12 See, e.g., Kornhauser, *supra* note 11, at 101–03; Schwartz, *supra* note 11, at 895–96; Thorndike, *The Thorndike Challenge*, *supra* note 11, at 691.

13 Thorndike, *The Thorndike Challenge*, *supra* note 11, at 691.

14 Bernasek, *supra* note 7 (internal quotation mark omitted) (quoting Professor Kotlikoff’s statement).

specific examples of its tax-enforcement strengths without exposing specific examples of its tax-enforcement weaknesses. The government publicizes specific examples whenever it reveals the details of any named individual's tax controversy.¹⁵ Because salient examples may implicate well-known cognitive biases, this strategic publicity function of tax privacy can cause individuals to develop an inflated perception of the government's ability to detect tax offenses, punish their perpetrators, and compel all but a few outliers to comply. Without the curtain of tax privacy, by contrast, individuals could see specific examples of the government's tax-enforcement weaknesses that would contradict this perception. After considering this new defence of individual tax privacy in the context of deterrence and reciprocity models of taxpayer behaviour, this Report argues that the strategic publicity function of tax privacy likely encourages individuals to report their taxes properly and that it should be exploited to enhance voluntary compliance.

The remainder of this Report proceeds as follows: Parts 1(b) and (c) provide an overview of the historical development of tax privacy rules in the United States and the current law. Part 2 describes the ways in which the IRS receives data regarding taxpayers' tax liabilities. Part 3 describes special information-sharing relationships between the IRS and particular institutions and individuals, including banks and lawyers. Part 4 describes the ways in which the IRS shares information with other government agencies at both the federal and state levels. Part 5 describes the ways in which the IRS shares information with the taxing authorities of other countries. Part 6 describes the tax return information that is accessible, and inaccessible, by the public under current law. In presenting this contrast, Part 6 reveals how tax privacy in the United States enables the IRS to publicize its tax enforcement strengths strategically. Part 7 describes private letter rulings and other special agreements between the IRS and specific taxpayers and public access to these arrangements. Finally, Part 8 discusses the consequences of infringement of tax privacy rules and illustrates these rules by applying them to a series of hypothetical situations.

1.2. Historical development

Proposals to make all or a portion of individual income tax returns publicly accessible have appeared frequently throughout the history of the United States, particularly when the government has sought innovative ways to collect tax revenue more effectively. Debate over these proposals always addresses the question of whether tax privacy causes individuals to be more or less likely to comply with the tax system. This part reviews the evolution of tax privacy from the Civil War to the present, summarizes the traditional justification for tax privacy as a means of encour-

15 See Joshua D. Blank & Daniel Z. Levin, *When Is Tax Enforcement Publicized?*, *Va. Tax Rev.* 30, 2010, 1, 8.

aging individual tax compliance, and describes—then critiques—recent opposition to the traditional justification.

Public access to individual tax return information in the United States has fluctuated widely over time, ranging from broad accessibility when the income tax was first introduced¹⁶ to the extensive restrictions on public disclosure that are in effect today.¹⁷

The Civil War. As the financial costs of the Civil War mounted and borrowing became an unsustainable source of funding,¹⁸ Congress enacted the nation’s first income tax in 1861¹⁹ and added public access provisions in 1862.²⁰ Soon after creating the new tax system, Congress required the Commissioner to permit public inspection of complete tax returns and the “proceedings of the assessors.”²¹

Within the next two years, major newspapers began publishing the details of individuals’ tax returns. By 1865 the *New York Times* regularly published a front-page feature titled *Our Internal Revenue*, which listed the income tax liabilities of prominent New Yorkers.²² A July 8, 1865 feature, for example, listed the tax liabilities of rich and famous citizens such as William B. Astor (USD 1.3 million), Cornelius Vanderbilt (USD 576,551), and Samuel Lord (USD 183,630).²³ The paper’s editors noted that they chose to publish only information that was “not a source of annoyance to the parties concerned,” rather than publishing entire income tax returns “for the gratification of an idle or morbid curiosity.”²⁴

In just a few years, however, public support for the income tax waned and so too did support for making returns public. Congress prohibited the publication of

16 See Act of July 1, 1862, ch. 119, §§ 15, 19, 12 Stat. 432, 437, 439 (repealed 1870).

17 I.R.C. § 6103 (2006). For detailed discussion of the history of public access to tax returns, see Howard M. Zaritsky, Cong. Research Serv., HJ5001A, Legislative History of Tax Return Confidentiality: Section 6103 of the Internal Revenue Code of 1954 and Its Predecessors (1974) *supra* note 9; Privacy Protection Study Comm’n, The Citizen as Taxpayer 1–3, 25–28, 54 (1977); and Richard D. Pomp, The Disclosure of State Corporate Income Tax Data: Turning the Clock Back to the Future, 22 Cap. U. L. Rev. 373, 378–405 (1993); Schwartz, *supra* note 11, at 884–87.

18 See Zaritsky, *supra* note 17, at 3; John F. Witte, The Politics and Development of the Federal Income Tax 67 (1985).

19 Act of Aug. 5, 1861, ch. 45, § 49, 12 Stat. 292, 309 (repealed 1862).

20 Act of July 1, 1862 §§ 15, 19.

21 Act of June 30, 1864, ch. 173, § 19, 13 Stat. 223, 228.

22 See, e.g., *Our Internal Revenue: The Eighth Collection District and Its Official Lists*, N.Y. Times, July 11, 1865, at 1; *Our Internal Revenue: The Fifth Collection District in Full*, N.Y. Times, July 16, 1865, at 5; *Our Internal Revenue: The Sixth Collection District in Full*, N.Y. Times, July 8, 1865, at 5; *Our Internal Revenue: The Third (Brooklyn) District Complete*, N.Y. Times, June 30, 1865, at 1.

23 *Our Internal Revenue: The Sixth Collection District in Full*, *supra* note 22, at 5.

24 *Our Internal Revenue: The Sixth Collection District in Full*, *supra* note 22, at 5.

income tax return information in 1870,²⁵ just before repeal of the income tax itself.²⁶

Early Twentieth Century. The issue of tax privacy next arose in the early twentieth century, shortly after the Sixteenth Amendment was ratified to authorize an income tax.²⁷ In 1913 Congress instructed that all tax returns would be open to public inspection, subject to an order of the President under rules prescribed by the Treasury Secretary.²⁸ In 1924 progressive US Senators expanded public access by spearheading legislation that permitted the public to view the amount of income tax paid by every taxpayer.²⁹

Throughout late 1924 and much of 1925, individuals' tax return information received extensive coverage in the press. After months of anticipation,³⁰ on 24 October 1924—the day after the Commissioner of Internal Revenue released the tax lists—the *New York Times* published a front-page article titled, in large, bold letters, *INCOME TAX RETURNS MADE PUBLIC; J.D. ROCKEFELLER JR. PAID \$ 7,435,169* and subtitled *Anyone Who Calls at Collector's Office May See the Returns Made for 1923*.³¹ The article reported on the tax liabilities of prominent citizens, including Rockefeller, Henry Ford, J. P. Morgan, and Charles M. Schwab.³² On the next day, the *Chicago Daily Tribune* published an article, titled *Movie Salary Lists Revealed by Tax Payment*,³³ that included estimates of the taxable incomes of Hollywood icons, including Douglas Fairbanks, Charlie Chaplin, and Gloria Swanson.³⁴ In noting the low taxable incomes of certain well-known actors,³⁵ the

25 Act of July 14, 1870, ch. 255, § 11, 16 Stat. 256, 259. Congress reaffirmed this prohibition when it later reinstated the income tax in 1894. Act of Aug. 27, 1894, ch. 349, § 34, 28 Stat. 509, 557–59.

26 Act of July 14, 1870 § 6 (providing that the income tax would expire in 1872).

27 US Const. amend. XVI.

28 Act of Oct. 8, 1913, ch. 16, § II(G)(d), 38 Stat. 114, 177.

29 Revenue Act of 1924, ch. 234, § 257(b), 43 Stat. 253, 293; see also Mark Leff, *The Limits of Symbolic Reform: The New Deal and Taxation, 1933–1939*, at 67 (1984) (describing the legislative policies behind the 1924 Act).

30 See, e.g., W. M. Kiplinger, *New “Peeping Tom” Law Worries the Taxpayer*, *N.Y. Times*, Aug. 17, 1924, at 6 (anticipating the coming law publicizing tax information).

31 *Income Tax Returns Made Public; J. D. Rockefeller Jr. Paid \$7,435,169; Ford Family and Company Pay \$19,000,000*, *N.Y. Times*, Oct. 24, 1924, at 1.

32 *Id.*; accord *Income Revelation Stirs Wall Street*, *N.Y. Times*, Oct. 25, 1924, at 1 (canvassing the reactions of various citizens upon the publication of taxpayer information); *New York—Its Big Income*, *N.Y. Times*, Oct. 25, 1924, at 2 (listing a variety of New Yorkers' tax information).

33 *Movie Salary Lists Revealed by Tax Payment*, *Chi. Daily Trib.*, Oct. 25, 1924, at 3.

34 *Id.*

35 *Id.* (noting the 1923 salaries of Cecil B. De Mille—USD 741—and Eric von Stroheim—USD 321—among others).

article predicted that “[t]he returns may prove a sharp shock to those who in the past have listened to tales by press agents on the salaries of the various stars.”³⁶

The Treasury Department, headed by Secretary Andrew Mellon (who paid the most income tax of Pittsburgh residents in 1923),³⁷ and President Calvin Coolidge vigorously opposed the publication of tax return information.³⁸ Amid their persistent lobbying efforts, in February of 1926, Congress enacted a new statute that required the Commissioner of Internal Revenue to make public lists of names and addresses, but not the tax liabilities, of all persons who filed income tax returns.³⁹

The Pink-Slip Requirement. The stock market crash of 1929 and the Great Depression caused Congress to consider public access to income tax returns once again, this time as a way to prevent tax evasion and the exploitation of tax loopholes.⁴⁰

While the Senate again passed legislation that would have allowed for the publication of tax returns in full,⁴¹ the legislative compromise in 1934 was a single sheet of paper known as the “pink slip.”⁴² As a result of the 1934 legislation, each taxpayer was required to attach to her annual federal income tax return a pink sheet of paper that contained her name and address, total gross income, total deductions, net income, total credits, and tax liability.⁴³ The pink slip, and not the entire tax return, would be open to public inspection.⁴⁴

Opposition to the pink-slip requirement was fierce. In early 1935 a conservative group called the “Sentinels of the Republic” launched a campaign to repeal the law.⁴⁵ Opponents warned repeatedly that the pink-slip requirement would aid kidnapers.⁴⁶ At the same time, the nation’s citizens were mesmerized by the trial of Bruno Hauptmann, who was charged with the kidnapping and murder of the infant

36 Id. In 1925, the US Supreme Court upheld the public access law in the face of a statutory challenge. *United States v. Dickey*, 268 U.S. 378, 385–86 (1925).

37 *Movie Salary Lists Revealed by Tax Payment*, supra note 33, at 2 (reporting Mellon’s tax paid for 1923 as USD 1,173,987).

38 See *Revenue Revision, 1925: Hearings Before the H. Comm. on Ways and Means*, 69th Cong. 8–9, 107 (1925) (statements of Andrew W. Mellon, Secretary of the Treasury, and M. L. Seidman, Member, New York Board of Trade and Transportation).

39 Revenue Act of 1926, ch. 27, § 257(e), 44 Stat. 9, 51 (amended 1934).

40 See Marjorie E. Kornhauser, *Shaping Public Opinion and the Law: How a “Common Man” Campaign Ended a Rich Man’s Law*, *Law & Contemp. Probs.* 73, 2010, 123, 129–30.

41 See Leff, supra note 29, at 67–68.

42 Kornhauser, supra note 40, at 130 (explaining the publicity provision of the Revenue Act of 1934 § 55(b)).

43 Id.

44 Id.

45 See Kornhauser, supra note 40, at 135–38; Raymond Pitcairn, *The Pink-Slip Strike*, *Saturday Evening Post*, 8 June 1935, at 23, 44.

46 See 79 Cong. Rec. 2594 (1935) (statement of Rep. Alfred Beiter); Kornhauser, supra note 40, at 140–41; *Income Publicity Called Kidnap Aid*, *N.Y. Times*, 25 Feb. 1935, at 2.

son of famous aviators Charles and Anne Morrow Lindbergh.⁴⁷ After a surge of public outcry, Congress repealed the law in April 1935⁴⁸ before it went into full effect.⁴⁹

The Nixon Administration. Congress did not revisit the issue of public access to tax return information until the years immediately following impeachment proceedings against President Richard M. Nixon. In its articles of impeachment, the House Judiciary Committee charged that President Nixon had sought to use the IRS—and, specifically, tax return information—for illegal ends.⁵⁰ According to the Committee, the Nixon Administration regularly requested tax return information regarding specific individuals, including then-Governor George Wallace and the head of the Democratic National Committee. The impeachment proceedings⁵¹ and subsequently released audio recordings⁵² exposed President Nixon’s personal requests for tax audits of political opponents, their supporters, and other members of Nixon’s “enemies list,”⁵³ though the Commissioner of Internal Revenue refused to comply.⁵⁴

1.3. General legal framework

As a result of the Tax Reform Act of 1976,⁵⁵ which responded to abuses that occurred during the Nixon administration,⁵⁶ current US tax law contains a general presumption that tax return information and tax returns are confidential and may not be disclosed by the IRS or other federal and state employees except under certain circumstances.⁵⁷

Section 6103 of the Internal Revenue Code protects the confidentiality of “returns” and “return information.” These concepts are defined broadly. Under the

47 See Lloyd C. Gardner, *The Case that Never Dies: The Lindbergh Kidnapping 2–3* (2004); Kornhauser, *supra* note 40, at 140–41.

48 Act of Apr. 19, 1935, ch. 74, 49 Stat. 158.

49 See Kornhauser, *supra* note 40, at 129.

50 H. Comm. on the Judiciary, *Impeachment of Richard M. Nixon, President of the United States*, H.R. Rep. No. 93-1305, at 3 (1974).

51 *Id.*

52 E.g., Richard Reeves, *President Nixon: Alone in the White House* 369 (2002) (quoting an audio recording of President Nixon stating, “Are we going after their tax returns? . . . Do you know what I mean? . . . And on the IRS, you could—are we looking into Muskie’s return? . . . Hubert? Hubert’s been in a lot of funny deals” (third alteration in original) (internal quotation marks omitted)).

53 Bob Kuttner, *Dean Tells of Nixon Pressure on IRS*, *Wash. Post*, 19 July 1974, at A9.

54 See Patricia Sullivan, *IRS Chief Successfully Fought Efforts to Use Tax Audits Against Nixon Foes*, *Wash. Post*, 6 Feb. 2009, at B6.

55 Pub. L. No. 94-455, 90 Stat. 1520 (codified as amended in scattered sections of 26 U.S.C.).

56 See IRS, *Dep’t of the Treasury, Pub. No. 4638, Disclosure & Privacy Law Reference Guide 1-7 to 1-9* (2007).

57 I.R.C. § 6103(a).

statute, for example, “return information” is defined to include “a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, over assessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the [Internal Revenue Service] with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.”⁵⁸ The confidentiality rules of Section 6103 also extend to any amendments filed with the IRS;⁵⁹ and any taxpayer’s identity, income, tax deductions and credits, or audit and penalty history, among many other items.⁶⁰

Section 6103 provides that its confidentiality protections do not extend to statistics that cannot be associated with a particular taxpayer.⁶¹ As a result, researchers in the United States may be permitted to access statistical information regarding the number of tax returns filed, total tax collected and aggregate value of tax penalties imposed by the IRS. It is not possible under the Freedom of Information Act, however, for individuals to request tax return information regarding a particular taxpayer.⁶²

2. Collection of Data

2.1. *How is data collected?*

The United States relies on “voluntary compliance” to impose and collect the income tax at the federal level. This phrase refers to the federal government’s reliance on individual taxpayers to calculate, report and pay their tax liabilities correctly and on time with minimal enforcement efforts from the IRS.

The primary mechanism with which the IRS gathers information regarding individuals’ tax liabilities is the annual individual tax return. In the United States, every individual who earns gross income in excess of an exemption amount must file an annual income tax return with the IRS.⁶³ For the 2012 tax year, the exemption amount was USD 3,800 for an unmarried individual.⁶⁴ Income tax returns must also be filed by corporations, estates with gross income of USD 600 or more,

58 I.R.C. § 6103(b)(2)(A).

59 I.R.C. § 6103(b)(1).

60 Id. § 6103(b)(2).

61 Id.

62 5 U.S.C. § 552(b)(3).

63 IRC § 6012(a)(1)(A).

64 IRC § 151(d). This amount is indexed for inflation each year. See, e.g., Rev. Proc. 2011-52 (stating personal exemption amount for 2012).

trusts with gross income of USD 600 or more, and other entities and organizations.⁶⁵

The IRS also relies heavily on information reports filed by third parties to verify the tax liability reported by the taxpayers themselves. For example, every employer who is engaged in a trade or business which compensates an employee in the amount of USD 600 or more (whether in the form of cash or other types of payments) for services performed by the employee during the taxable year must file an information report with the IRS.⁶⁶ The employer must also provide this form to the employee.⁶⁷ The IRS uses this information report to verify that the employee has reported the correct amount of income on her own individual tax return. Because the IRS can use this report to identify any discrepancy between the amount of income reported by the employer and the amount reported by the employee, the voluntary compliance rate among individuals who are subject to information reporting by employers is extraordinarily high. According to the IRS, for taxpayers who earn wages and salaries that are subject to third-party reporting, the amount of wages and salary income that is not reported correctly is only about 1%.⁶⁸ For taxpayers who earn wages and salary income that is *not* subject to third-party withholding and reporting, however, the amount this is misreported is 56%.⁶⁹ Information reporting extends to many additional taxpayers and transactions other than just employers and employees.⁷⁰

Since 1998 the federal government has encouraged, and in some cases, required, taxpayers to file their tax returns electronically. While individuals are not required to file their annual tax returns electronically, the vast majority of individuals currently choose this method of filing. According to the IRS, approximately 80% of individual tax returns are filed electronically each year.⁷¹ Under current law, specified tax return preparers are required to file certain federal income tax returns that they prepare and file for individuals, trusts, or estates electronically.⁷² In addition, many corporate taxpayers are required to file their tax returns electronically. Corporations with USD 10 million or more in total assets and that file 250

65 See IRC §§ 6012(a)(2)-(8).

66 IRS Form W-2.

67 For instructions, see IRS, General Instructions for Forms W-2 and W-3, available at <http://www.irs.gov/pub/irs-pdf/iw2w3.pdf>. (2013)

68 IRS, IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study, IR-2012-4, 6 Jan. 2012.

69 See *id.*

70 For discussion of information-reporting rules in the United States, see generally Leandra Lederman, Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?, *Fordham L. Rev.* 78, 2010, 1733.

71 IRS, IRS Urges Tax Professionals to Prepare Now for New e-File Rules, IR-2011-100, 12 Oct. 2011.

72 IRC § 6011(e)(3).

or more returns a year are required to electronically file their tax returns with the IRS.⁷³

2.2. *What kind of additional information?*

Individual tax returns contain a significant amount of information other than a taxpayer's taxable income. For example, IRS Form 1040, the annual income tax return, reveals a taxpayer's Social Security Number, marital status, names and Social Security Numbers of dependents (such as children), receipt of alimony resulting from a divorce, receipt of unemployment compensation, existence of outstanding student loans, and many other types of personal information.⁷⁴ This personal information appears on the individual's annual tax return because it directly affects the calculation of the individual's taxable income under the income tax laws. All of this information is considered "return information"⁷⁵ and is protected by the broad tax privacy rules discussed earlier.

2.3. *Proportionality and other relevant principles*

In many jurisdictions, such as the European Union, principles of proportionality play a significant role in determining whether the government can engage in particular actions to achieve its objectives. In the United States, the principle of proportionality does not explicitly govern the limits on information that the IRS may collect from taxpayers in order to enforce the tax law.

3. Specific relationships

3.1. *Banks*

The US government has enacted a variety of measures that address financial activities that occur through banks and other financial institutions. While the information-reporting requirements that affect these institutions and their customers could fill volumes, this part briefly describes the major reporting requirements that affect financial institutions.

Investment Income Reporting. Banks are required to report to the IRS information regarding the income that their customers earn in their individual banking and checking accounts. Each January, banks provide to the IRS a report, IRS Form 1099-INT, which summarizes the interest income paid to their account holders. The interest that must be reported includes interest paid by the bank on savings ac-

73 Treas. Reg. § 301.6011-5(a).

74 IRS Form 1040.

75 IRC § 6103(b)(2)(A).

counts, interest-bearing checking accounts and bonds. Banks provide this form to the individual account holders as well, and they use them to complete their annual personal tax returns. Just as the IRS uses information reports from employers to verify the income reported by employees, the IRS compares the information reports provided by banks with the investment income reported by taxpayers to the IRS.

Money Laundering Reporting. Whenever large amounts of money are deposited to or withdrawn from US bank accounts, banks may be required to report these transactions to the IRS. Under currently law, if more than USD 10,000 is deposited to or withdrawn from a bank, the bank may be required to file a “Currency Transaction Report” with the IRS. Several exemptions prevent this reporting requirement from applying to certain retail and other customers. This reporting requirement is designed to enable the IRS to detect instances of money laundering and other financial crimes. If the bank is required to file a Currency Transaction Report, it must disclose the identity of the individual involved to the IRS.

Tax Evasion Reporting. In order to prevent tax evasion through the use of off-shore bank accounts, the federal government has also enacted a number of special rules that apply to individuals who hold interests in accounts in non-US banks.

A United States person who holds a financial interest in a non-US bank account must file a Report of Foreign Bank and Financial Accounts (FBAR) if the aggregate value of the foreign financial accounts exceeds USD 10,000 at any time during the calendar year.⁷⁶ If a taxpayer non-wilfully fails to file an FBAR, she can be subject to penalty of up to USD 10,000. If she wilfully fails to file an FBAR, she can be subject to a penalty as high as 50% of the value of the non-US account, and additional criminal penalties.⁷⁷ There is no cap on the amount of this penalty. As a supplement to the FBAR reporting requirement, US taxpayers are also required to file an information return if they hold interests in any “specified foreign financial assets,” if the aggregate value of these assets is more than USD 50,000.⁷⁸ These assets include depository accounts in foreign financial institutions, securities or stock issued by foreign persons and financial instruments held for investment issued by another person that is not a US person.

In addition, in 2010, Congress enacted the Foreign Account Tax Compliance Act (FATCA). Under FATCA, starting in 2014, foreign financial institutions are required to report directly to the IRS information about accounts that are held by US taxpayers, or that are held by foreign entities in which US taxpayers own substantial interests.⁷⁹ If foreign financial institutions do not agree to provide this information to the IRS, a withholding agent is required to withhold 30% of any

76 TD F 90-22.1, Report of Foreign Bank and Financial Accounts, available at <http://www.irs.gov/pub/irs-pdf/f90221.pdf>. (2013)

77 31 U.S.C. §5321(a)(5).

78 IRC § 6038D.

79 IRC §§ 1471-1474.

“withholdable payments” made to the foreign financial institution.⁸⁰ These payments include US-source income that is fixed or determinable, annual or periodical income (FDAP) or gross proceeds from a sale or redemption of property.

3.2. *Lawyers/tax advisors*

Taxpayers are required to file special disclosure statements with the IRS Office of Tax Shelter Analysis when they engage in “reportable transactions” during the taxable year.⁸¹ These transactions include: “listed” transactions (strategies that the government considers to be most clearly at odds with congressional intent); “transactions of interest” (arrangements for which the IRS and Treasury Department lack enough information to determine whether they should be identified specifically as tax avoidance transaction[s]); confidential transactions (where an advisor limits the taxpayer’s ability to disclose the tax advice to others); transactions with contractual protection (where an advisor promises a refund to the taxpayer if the government does not respect the transaction); and loss transactions (which consist of certain sales or exchanges of stock, assets, and other property that lead taxpayers to claim large losses for tax purposes).

These disclosure obligations apply not only to the taxpayers who participate in the reportable transactions, but also to their lawyers, accountants and other advisors. If an advisor recommends a reportable transaction in exchange for a minimum fee⁸² and the taxpayer actually pursues the transaction, the advisor is characterized by the law as a “material advisor.”⁸³ Material advisors must file a disclosure statement with the Office of Tax Shelter Analysis describing the reportable transactions they have recommended in exchange for a minimum fee.⁸⁴ In addition, every material advisor must maintain a list of the taxpayers that have caused her to be characterized as a material advisor.⁸⁵ The IRS may request this list at any time.⁸⁶

4. Sharing Information Domestically

While the US federal tax law contains broad tax privacy provisions in Section 6103 of the Internal Revenue Code, it also provides a large amount of exceptions under

80 IRC §§ 1471(a).

81 See Sheryl Stratton, Inside OTSA: A Bird’s-Eye View of Shelter Central at the IRS, *Tax Notes* 100, 2003, 1246, 1246–47. Taxpayers are also required to attach the disclosure statement to their annual tax returns. Treas. Reg. § 1.6011-4(e).

82 Treas. Reg. § 301.6111-3(b)(3)(i)(B)

83 Treas. Reg. § 301.6111-3(b)(1).

84 Treas. Reg. §§ 301.6111-3(d)(1), (e).

85 Treas. Reg. § 301.6112-1(a).

86 Treas. Reg. § 301.6112-1(e).

which returns and return information may be shared by the IRS with other agencies and institutions domestically.⁸⁷ Many of these exceptions concern tax administration, such as exceptions that permit the IRS to provide a taxpayer with a copy of his own tax return⁸⁸ or to share return information with state taxing authorities.⁸⁹ But the exceptions implicate non-tax-administration purposes as well. US federal tax law, for instance, allows the IRS to disclose tax return information to other law enforcement agencies if the disclosure is relevant to any terrorist incident or threat.⁹⁰ As another example, upon the grant of an order by a federal District Court judge or magistrate, the IRS may also share an individual's tax return with law enforcement agents for the purpose of assisting them to locate a fugitive from justice.⁹¹

5. Sharing Information Internationally

The IRS shares information with the taxing authorities of other nations pursuant to exchange of information provisions contained in tax treaties. Tax treaties enable the United States and its treaty partners to avoid double taxation and also to provide information that could enable each nation to enforce the tax law. As of 2011 the United States entered such information sharing arrangements with 90 other jurisdictions. During the five-year period between 2006 and 2010, the IRS processed 5,111 requests for information. The vast majority of these requests (4,217) were incoming requests for information from the taxing authorities of other nations and only a small minority (894) of these requests consisted of outgoing requests for information from the IRS to other taxing authorities.⁹²

While IRS does not reveal the specific types of information that it shares with treaty partners through exchange of information agreements, it has developed processes for responding to incoming requests and preparing outgoing requests.⁹³ Under these procedures, all incoming requests to the IRS must contain (i) the identity of the US taxpayer who is subject to the inquiry, (ii) an itemized list of all information requested, (iii) an explanation of the relevance to the non-US taxing authority of the information requested and (iv) an explanation of how the requested information relates to taxes covered by the information sharing agreement.⁹⁴ IRS officials often ask non-US taxing authorities to provide additional information be-

87 See id. §§ 6103(c)–(o).

88 Id. § 6103(c).

89 Id. § 6103(d).

90 Id. § 6103(i)(3).

91 § 6103(i)(5).

92 See US Gen. Acc. Office, *IRS's Information Exchanges with Other Countries Could Be Improved through Better Performance Information*, September 2011, available at <http://www.gao.gov/new.items/d11730.pdf>. (2011).

93 See id. at 8.

94 See id.

fore responding to requests. When the IRS requests information from the taxing authorities of treaty partners, it follows a similar procedure in constructing the request. The IRS provides the name and address of the taxpayer under examination, the type of tax and tax years at issue, an explanation of how the information relates to an investigation by the IRS and the date by which the IRS needs to receive the requested information.⁹⁵

6. Access to Data by the Public

6.1. *Decisions by the tax administration and the courts*

Throughout the past 150 years, the contours of the tax privacy debate in the United States have remained remarkably unchanged. Tax privacy advocates speculate that individuals would fear embarrassment and other consequences if tax returns were publicly accessible. Public-access proponents, by contrast, hypothesize that potential tax evaders would fear increased chances of IRS detection and social stigma; tax privacy advocates refute these claims, and so forth.

One explanation for the recurrent nature of the tax privacy debate is that its focus thus far has been incomplete. Both sides have fixated on the question of how taxpayers would comply with the tax system if they knew that other taxpayers could see their personal tax returns. Neither side, however, has addressed the converse question: How would taxpayers comply with the tax system if they could see *other* taxpayers' tax returns?

This part investigates possible answers to that unexplored question. To consider the relationship of tax privacy and individual tax compliance from this new perspective, this part performs the following thought experiment: it compares specific tax-enforcement examples that individuals see today under current tax privacy rules to the specific examples that they could see in a regime in which all tax return information—including tax returns, liabilities, audit notices, and settlement agreements with the IRS—were publicly accessible. By comparing a world with tax privacy to a world without it, this experiment highlights the effects of tax privacy on individual taxpayers' perceptions.

Why Not Seeing Is Believing. When the US government describes tax-enforcement actions against specific taxpayers today, it seeks to portray itself as capable of detecting abuse effectively and applying tax penalties, whether civil or criminal, aggressively. Because the government has the unilateral power to pursue a public tax-enforcement action against a specific taxpayer,⁹⁶ it plays a unique role in promoting strong tax enforcement examples.

95 See *id.*

96 See 28 C.F.R. § 0.70 (2011) (granting to the Assistant Attorney General of the Tax Division authority to prosecute virtually all civil and criminal proceedings under the internal revenue laws).

Statistics released by the IRS and other government agencies, however, reveal that these examples do not fully represent reality. If we were to lift the curtain of tax privacy by making tax return information that is currently confidential—tax returns, records of tax-penalty payments, and audit histories, among other items—open to public inspection, individuals would see many salient examples of weak tax enforcement against specific taxpayers that could detract from the perception of the government as strong and effective.⁹⁷

This part examines the way in which tax privacy filters the specific examples of tax enforcement that individuals see—and do not see—and examines their potential behavioral effects on individuals due to their perceptions of the government’s tax-enforcement capabilities.

6.1.1. *Tax Enforcement Successes That the Public Sees*

By carefully publicizing salient examples of tax-enforcement actions against specific taxpayers, the government actively attempts to influence individual taxpayers’ perceptions of its ability to detect abusive tax activities, levy strong tax penalties against offenders and achieve legal victories. The following discussion describes the specific examples of strong tax-enforcement actions that individuals see today.

Detected Abuse. The government deliberately attempts to raise public awareness of its ability to detect abusive tax activities by showcasing memorable instances of its detection successes. Salient examples of the government’s detection of the abusive tax activities of specific taxpayers may cause individuals to increase their subjective probabilities that the government will detect them if they engage in aggressive or abusive tax planning.

The government pursues public tax-enforcement efforts against specific taxpayers in part to influence the perceptions of the general public. A former head of the IRS’s Criminal Investigation Division acknowledged that the IRS seeks to “generate multiple press stories nationwide about particular cases”⁹⁸ to “deter . . . potential cheaters.”⁹⁹ To aid its publicity efforts, the Criminal Investigation Division assigns dozens of “public information officers” in each of its field offices to serve as “the local . . . media contact[s] to provide public record information to the media about the field office[s]’ cases.”¹⁰⁰ Further, government officials have

97 Cf. IRS Oversight Bd., 2010 Taxpayer Attitude Survey 14 (2011), available at <http://www.treasury.gov/irsob/reports/2011/IRSOB%202010%20Taxpayer%20Attitude%20Survey.pdf> (reporting that 46% of surveyed taxpayers believed the IRS maintained an effective balance between enforcement activities and customer service). (2011).

98 Mark E. Matthews, *New IRS Publicity Strategy*, US Att’ys’ Bull., July 2001, at 15.

99 Id. at 16; accord Kristen A. Parillo, *Korb: Tax Press Plays Key Role in IRS Communications Strategy*, *Tax Notes* 118, 2008, 478, 478–79 (describing and quoting similar statements by former IRS Chief Counsel Donald Korb).

100 Jeremiah Coder, *Conversations: Eileen Mayer*, *Tax Notes* 116, 2007, 738, 740.

revealed that they carefully monitor the “publicity rate,” a measure of the extent to which publicly announced civil and criminal tax cases receive press coverage.¹⁰¹

The media often work in tandem with the government by publicizing the government’s tax-enforcement actions against specific taxpayers, particularly when these actions involve criminal sanctions, celebrities, or both. Reporters often print descriptions of tax-enforcement actions that they excerpt directly from government press releases and announcements.¹⁰² The media’s tendency to publicize specific tax-enforcement examples peaks reliably during the weeks leading up to Tax Day each year.¹⁰³

Every year, the government announces specific cases in which it has detected taxpayers who have engaged in tax fraud. In addition to issuing its annual “dirty dozen” list of tax scams that bear these traits,¹⁰⁴ the government provides specific examples of taxpayers who have attempted to engage in these strategies and have failed to escape detection, including celebrities and other prominent taxpayers. Recent public examples of the government’s successful detection of tax fraud by specific high-profile individuals include Joe Francis, the creator of the *Girls Gone Wild* videos, who attempted to deduct USD 20 million in phony business expenses;¹⁰⁵ Richard Hatch, the former star of the reality television show *Survivor*, who attempted to omit his USD 1 million prize and other items from taxable income;¹⁰⁶ and actor Nicolas Cage, who improperly deducted over USD 3 million for meals, gifts, and expenses associated with his Gulfstream jet as business expenses.¹⁰⁷

Often the government’s publicly announced tax-enforcement efforts involve more sophisticated forms of tax evasion by prominent business figures and other wealthy individuals. For example, in April 2010, following its settlement with UBS, the Swiss global financial services company, regarding its promotion of off-shore banking activities, the US Department of Justice Tax Division announced separate criminal pleas and civil settlements involving specific former clients of

101 See, e.g., *id.*

102 See, e.g., Amy Bonawitz, “Girls Gone Wild” Founder Indicted, CBSNews.com (Feb. 11, 2009, 5:03 PM), <http://www.cbsnews.com/stories/2007/04/11/entertainment/main2673413.shtml> (citing Press Release, Dep’t of Justice, Creator of Girls Gone Wild Indicted for Tax Evasion (Apr. 11, 2007), available at <http://www.justice.gov/tax/txdv07237.htm>).

103 See Blank & Levin, *supra* note 15, at 18.

104 See, e.g., Beware of IRS’ 2009 “Dirty Dozen” Tax Scams, IRS (Apr. 13, 2009), <http://www.irs.gov/newsroom/article/0,,id=206370,00.html>.

105 Press Release, Dep’t of Justice, *supra* note 102.

106 Press Release, US Dep’t of Justice, “Survivor” Winner Richard Hatch Is Sentenced to 51 Months in Prison for Tax Evasion (May 16, 2006), available at http://www.justice.gov/tax/usaopress/2006/txdv06_RH_TaxEvasion.pdf.

107 Janet Novack & William P. Barrett, Nic Cage’s Other Weekend Premiere: IRS Settlement, Forbes.com (Sept. 5, 2008, 3:11 PM), available at http://www.forbes.com/2008/09/05/hollywood-taxes-cage-biz-media-cz_wb_jn_0905cage.html.

UBS on each of the three days up to and including Tax Day, when seven individuals were charged on that single day with hiding over USD 100 million in foreign bank accounts.¹⁰⁸ The government also uses specific examples to publicize its detection of prominent or wealthy individuals who have failed to file required disclosure forms regarding suspicious tax activities with the government.

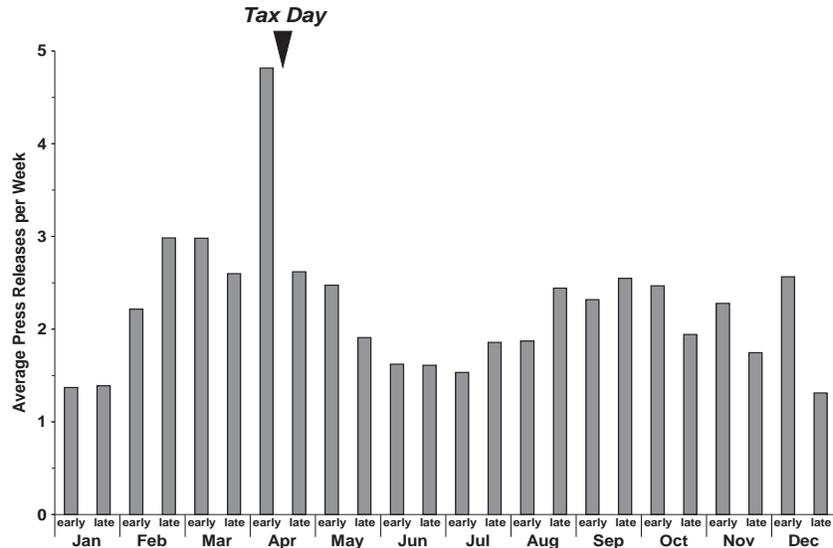
Not only does the government publicize specific examples of its detection successes, but it also announces them disproportionately during the weeks leading up to Tax Day compared to the rest of the year. An empirical study of the US Department of Justice Tax Division during the seven-year period from 2003 through 2009 found that in the two weeks leading up to Tax Day, the government issued more than double the number of tax-enforcement press releases per week than it did during the rest of the year.¹⁰⁹

The chart below shows a graphic illustration of our findings of the average frequency of tax-enforcement press releases issued throughout the year from 2003 through 2009:

108 See Press Release, Dep't of Justice, Former UBS Client Pleads Guilty to Hiding Assets in Secret Offshore Bank Accounts (Apr. 13, 2010), available at <http://www.justice.gov/opa/pr/2010/April/10-tax-401.html>; Press Release, Dep't of Justice, Seven UBS Clients Charged With Hiding over \$100 Million in Secret Swiss Bank Accounts to Defraud the IRS (Apr. 15, 2010), available at http://www.justice.gov/tax/txdv10_USB_Clients.htm; Press Release, Stacey A. Levine & Michael C. Vasiliadis, U.S. Dep't of Justice, Former UBS Client Pleads Guilty to Failing to Report over \$1 Million in Swiss Bank Accounts (Apr. 12, 2010), available at <http://www.justice.gov/usao/nj/Press/files/pdf/2010/Abrahamsen,%20Harry%20Plea%20PR.pdf>.

109 Blank & Levin, *supra* note 15 at 17. For the time window from 1 April to Tax Day, the study found that the government issued 128% more tax-enforcement press releases per week than during the rest of the year. *Id.*

FIGURE 1
 FREQUENCY OF TAX-ENFORCEMENT PRESS RELEASES (2003–2009)¹¹⁰



The disproportionately large number of tax-enforcement press releases issued during the two weeks prior to Tax Day compared to the rest of the year was highly statistically significant.¹¹¹ In other words, this analysis strongly supported the hypothesis that the difference did not occur by chance. The timing of the government’s public announcements of tax-enforcement actions against specific taxpayers coincides with the weeks leading up to Tax Day, the time of year when the vast majority of individual taxpayers are in the process of preparing their own individual tax returns.¹¹²

Strong Tax Penalties. While the Internal Revenue Code contains a myriad of tax penalties that apply in varying degrees of severity, the government’s public announcements and media reports regarding specific taxpayers who have received tax penalties almost exclusively involve criminal sanctions or high civil tax penalties. These salient examples may lead individuals to overvalue the tax penalties that may apply to many tax offenses.

In the examples of detected abuse described above, not only did the government publicly announce its success in catching non-compliant taxpayers, but in

110 Id. at 18.

111 “The negative binomial regression model’s likelihood ratio chi-square [was] 23.48 . . .” Id. at 16. The p-value was only .0000013. Id. These statistics mean, essentially, that there is a one-in-791,637 chance that this difference in the issuance of tax-enforcement press releases was random. Id.

112 Cf. id. at 13 (“[T]he vast majority of annual individual income tax returns are filed with the [IRS] between February 1 and Tax Day each year. In 2008, for example, nearly 80% of all annual individual income tax returns were filed during this period.” (footnote omitted)).

many cases, it also announced that these taxpayers would face criminal sanctions. When the government announces a public tax-enforcement action against a celebrity taxpayer who has engaged in a flagrant omission of taxable income, it frequently reveals that the taxpayer could face prison time.¹¹³ Similar results occur in public tax-enforcement actions against individuals who have used more sophisticated tax-evasion methods, such as many former UBS clients who used offshore bank accounts to hide income and received prison or probation sentences as a consequence.¹¹⁴ Further, when the government announces that it has detected habitual cash-economy tax evaders, it often states its intention to pursue criminal sanctions.¹¹⁵ Consistent with the timing patterns described above, the government's announcements of criminal tax sanctions against specific taxpayers occur disproportionately in the weeks leading up to Tax Day compared to the rest of the year.¹¹⁶

Tax-Controversy Victories. Last, the government may publicize its successes in both criminal and civil tax litigation to foster the perception that taxpayers have a low chance of prevailing in a tax controversy against it. Government officials have stated publicly that they believe that government victories in criminal and civil tax controversies “receive wide media coverage” and, as a result, have “a significant multiplier effect on voluntary compliance.”¹¹⁷ Consistent with these words, the government reinforces the perception that it prevails in most tax controversies by publicizing vivid descriptions of its victories against specific taxpayers in criminal and civil tax litigation in the public courts.

The most memorable public tax disputes often involve criminal tax cases against specific taxpayers. The Tax Division litigates these cases, and its lawyers win almost all of them. In 2009, for example, the government won 98% of all criminal tax controversies that it prosecuted.¹¹⁸ Just two years earlier, this success rate was 100%.¹¹⁹ Consequently, when individuals hear about a criminal tax-enforcement action against a specific taxpayer through news reports or other sources, they almost always learn that the taxpayer involved has entered a guilty plea or received a criminal sanction, such as a prison sentence. Even when the government loses on the merits on the heftiest criminal charges against a particular

113 See, e.g., Press Release, Dep't of Justice, Wesley Snipes Surrenders on Tax Charges (Dec. 8, 2006), available at media.tbo.com/graphics/120806snipes.pdf; Press Release, US Dep't of Justice, *supra* note 106. (2006).

114 For the government's announcement of UBS clients who have received criminal sentences, see *Offshore Tax-Avoidance and IRS Compliance Efforts*, IRS, <http://www.irs.gov/newsroom/article/0,,id=110092,00.html> (last updated 13 Dec. , 2011).

115 See, e.g., Press Release, Dep't of Justice, Rhode Island Machine Shop Owners Convicted of Tax Fraud (Mar. 30, 2009).

116 Blank & Levin, *supra* note 15, at 18.

117 Tax Div., US Dep't of Justice, FY 2011 Congressional Budget 25 (2010), available at <http://www.justice.gov/jmd/2011justification/pdf/fy11-tax-justification.pdf>, at 2. (2011).

118 *Id.* at 23.

119 See *id.*

taxpayer, it often succeeds in obtaining a conviction on lesser charges or enters into a plea agreement with the taxpayer.¹²⁰

6.1.2. *Tax Enforcement Weaknesses That the Public Does Not See*

The examples of tax enforcement that are visible today portray the government as enforcing the tax law effectively and efficiently. It catches tax cheats, wins in court, and ensures that strong punishments for tax non-compliance are levied. Yet these examples of successful tax enforcement feature only a tiny sampling of taxpayers. Taxpayers in the US cannot see the details of other taxpayers' tax returns or their disputes with the government. They are not visible because tax privacy hides them from public view.

What would the public see in a world without individual tax privacy? To explore the possibilities, let us imagine a regime of public access in which the tax return information of individuals that is protected by tax privacy could be viewed by the media and the general public. In this hypothetical public-access regime, a taxpayer's tax return and related information could be made publicly available in a searchable online database, so that the reporters and ordinary citizens could examine any taxpayer's tax returns, audit history, settlement agreements, and other tax return information.

As the discussion below reveals, by lifting the curtain of tax privacy, the public would see very different examples of tax enforcement involving specific taxpayers compared to those we see today. In contrast to the examples the public sees today, a public-access regime could enable it to see concrete examples of the government failing to detect abusive tax activities, declining to apply tax penalties (whether criminal or civil), and offering taxpayers concessions in its substantive legal challenges.

Undetected Abuse. Without the curtain of tax privacy, the media—and ultimately ordinary citizens—could observe concrete examples of taxpayers who may have engaged in abusive tax activities, yet escaped detection by the IRS. The media's focus on instances in which the IRS appeared to fail to detect abuse could lead individuals to reduce their own subjective probabilities of being detected by the IRS.

Despite the government's dramatic public announcements of its successful detection of tax non-compliance, ranging from blatant tax fraud to sophisticated tax shelter activity, publicly available tax-enforcement statistics strongly suggest that many taxpayers engage in abusive tax avoidance or tax evasion without prompting an IRS audit or other investigation. For example, as a result of the IRS's limited budgetary resources, the audit rate for individual taxpayers perennially hovers

120 See, e.g., Wesley Snipes Gets 3 Years for Not Filing Tax Returns, N.Y. Times, 25 Apr. 2008, at C3 (noting that the defendant was acquitted of tax fraud but convicted of wilful failure to file a federal tax return).

around 1% (in 2009, for example, it was 1.03%).¹²¹ Other public reports indicate that hundreds of thousands of citizens simply fail to file tax returns at all, and the IRS lacks the resources to investigate these cases.¹²² Publicly available statistics also reveal that the IRS has reduced its audit coverage of wealthy taxpayers over the last decade (for example, by 36% from 2007 to 2008),¹²³ yet studies show that taxpayers with adjusted gross incomes of USD 500,000 to USD 1,000,000 fail to accurately report 21% of their income on average.¹²⁴ Consistent with this data, IRS officials have conceded that they do not audit many instances of abuse.¹²⁵

Instead of anonymous statistics, the elimination of tax privacy would reveal the identities of taxpayers who have engaged in abusive tax planning and whom the IRS has failed to pursue. Especially in the case of celebrities and government officials, public access to tax return information could generate a media frenzy over tax returns that appear to show low taxable income compared to these individuals' apparent wealth or other suspicious items that may imply the use of abusive tax-planning techniques. Likewise, for curious citizens, public access to tax return information could offer examples of friends and neighbours who may have claimed improper tax positions on their tax returns.

If individuals were to encounter examples of specific taxpayers who had engaged in abusive tax activities, they may conclude that the IRS has failed to detect these instances unless the publicly available tax return information shows otherwise. Upon discovering a specific taxpayer's apparent abuse, the media, or even ordinary individuals, could review the taxpayer's publicly available tax return information to determine whether the IRS had sent the taxpayer an audit letter (a "Summary of Proposed Changes")¹²⁶ or a statutory notice of deficiency,¹²⁷ whether the taxpayer had filed a protest with the IRS Appeals Division in response to a revenue-agent letter,¹²⁸ or whether the taxpayer had filed any amended tax returns that revised the original abusive tax position. If none of these items were present, then

121 Fiscal Year 2009 Enforcement Results, IRS, http://www.irs.gov/pub/irs-drop/fy_2009_enforcement_results.pdf (last visited 23 Sept. 2011).

122 See generally David Cay Johnston, *Perfectly Legal* 204–05 (2003).

123 See IRS Audit Rate for Millionaires Plummet, TRAC IRS (Mar. 23, 2009), <http://trac.syr.edu/tracirs/latest/204/>. (2009).

124 See, e.g., Andrew Johns & Joel Slemrod, *The Distribution of Income Tax Noncompliance*, 63 *Nat'l Tax J.* 397, 404, 413 (2010).

125 Johnston, *supra* note 122, at 200 (quoting Frank Keith, former senior IRS spokesman, as stating that, "with limited resources[,] the I.R.S. must often choose which cases to pursue" (internal quotation marks omitted)).

126 CP 2000 Sample Contents Page 1, IRS, <http://www.irs.gov/individuals/article/0,,id=169287,00.html>. (2000).

127 I.R.C. § 6212(a).

128 See Letters and Notices Offering an Appeal, IRS, <http://www.irs.gov/individuals/article/0,,id=160744,00.html> (last updated 25 July 2011) (describing IRS Letter 525—General 30 Day Letter).

the media's discovery of a case of abuse involving a specific taxpayer could lead to the perception that the IRS had failed to detect this abuse on its own.

Weak Tax Penalties. A public-access regime would also likely enable the media to publicize instances in which tax evaders *were* detected by the IRS but did not bear strong criminal or civil tax penalties. As opposed to the specific examples of tax penalties that individuals encounter today, the statutory and administrative exceptions and standards inherent in these tax-penalty rules prevent the government from applying hefty civil or criminal tax penalties in the vast majority of tax controversies.

The government pursues criminal tax penalties against individual taxpayers in a minute number of cases.¹²⁹ A public-access regime, consequently, would likely reveal memorable examples of high-profile individuals who participated in fraudulent tax schemes without facing criminal prosecution. The primary reason for the government's reluctance to seek criminal tax penalties is that it must prove in court that the taxpayer intended to defraud the government.¹³⁰ Thus, one explanation for the government's reluctance to pursue criminal tax sanctions against taxpayers who have participated in tax fraud is that the available evidence may not satisfy the heightened burden of proof.

Instead of pursuing criminal tax sanctions in many cases, the government attempts to reach a civil settlement with the taxpayer or even creates special amnesty programs that encourage taxpayer disclosure by removing the threat of criminal tax penalties. For example, in September 2009, after reaching an exchange-of-information agreement with UBS,¹³¹ the IRS created an amnesty program under which taxpayers could voluntarily disclose their use of offshore accounts and, in exchange, avoid the imposition of criminal tax-fraud penalties.¹³² Within weeks of the IRS's announcement of the amnesty program, 15,000 taxpayers participated.¹³³ Even though some rich and famous individuals probably participated in the amnesty programme, tax privacy prevented the media from reporting their identities.

With public access to tax return information, however, the media could generate vivid news stories of recognizable, high-profile taxpayers who engaged in tax fraud but avoided the criminal or civil penalties by participating in IRS amnesty

129 See Tax Div., US Dep't of Justice, FY 2011 Congressional Budget 25 (2010), available at <http://www.justice.gov/jmd/2011justification/pdf/fy11-tax-justification.pdf>, at 1, 14, 23, 25 (discussing the number of authorized criminal prosecutions in given years). (2010).

130 U.S. Tax Ct. R. Prac. & P. 142(b).

131 IRS to Receive Unprecedented Amount of Information in UBS Agreement, IRS (Aug. 19, 2009), <http://www.irs.gov/newsroom/article/0,,id=212124,00.html>. (2009).

132 Voluntary Disclosure: Questions and Answers, IRS (Feb. 8, 2011), <http://www.irs.gov/newsroom/article/0,,id=210027,00.html>. The IRS announced a second special offshore voluntary disclosure initiative on 8 February 2011. Second Special Voluntary Disclosure Initiative Opens, IRS (Feb. 8, 2011), <http://www.irs.gov/newsroom/article/0,,id=235695,00.html>. (2011).

133 Second Special Voluntary Disclosure Initiative Opens, *supra* note 132.

programs. These examples would stand in stark contrast to the government's public announcements describing the convictions of wealthy and prominent individuals who have hidden income from the IRS in offshore bank accounts.

Tax-Controversy Concessions. Last, in a public-access regime, the media would likely focus on tax controversies in which the government made legal concessions or entered settlements to avoid facing uncertain odds in court. Reporters would also likely investigate instances in which IRS agents made errors in applying the law that were subsequently reversed by other IRS officials. These reports would conflict with the strong examples of legal victories against taxpayers that the government publicizes widely today.

Even though the tax disputes involving specific taxpayers that individuals see today overwhelmingly feature government victories, in reality, the IRS regularly settles tax controversies and reverses the positions of its field agents.¹³⁴ The IRS Appeals Division settles over 85% of all disputes.¹³⁵ The Appeals Division may review a field agent's notice of deficiency after the taxpayer files an appeal with the IRS and determine that the IRS's legal claim is not strong enough to merit litigation in a public forum.¹³⁶ And as was discussed above, the IRS frequently creates taxpayer-amnesty programs in which it agrees not to pursue litigation against a taxpayer in exchange for certain information.¹³⁷ Public access to tax return information would enable the media to publicize those examples by revealing settlement agreements and instances in which specific taxpayers paid the IRS lower amounts than those contained in the original statutory notices of deficiency.

6.1.3. Strategic Publicity and Tax Compliance

By enabling the government, with the help of the news media, to influence individual taxpayers' perceptions of its tax-enforcement capabilities, tax privacy may bolster the government's deterrence efforts. Because tax privacy allows the government to publicize examples of strong tax enforcement against specific taxpayers almost exclusively, the government may inflate taxpayers' perceptions of the two principle determinants of deterrence: the probability of detection and the expected costs of non-compliance. Without tax privacy, examples of weak tax enforcement against specific taxpayers could surface and have the opposite effect on individuals' perceptions and tax-compliance decisions.

In addition to enhancing deterrence, the strategic-publicity function of tax privacy may also enable the government to increase confidence among compliant in-

134 See David M. Fogel, The Inside Scoop About the IRS's Appeals Division, *Tax Notes* 99, 2003, 1503, 1503-04 (internal quotation marks omitted), at 1504.

135 B. John Williams, Jr., Chief Counsel, Internal Revenue Serv., Resolving Tax Shelters: By Settlement or Litigation, Address Before the Chicago Bar Association Federal Taxation Committee (25 Feb. 2003) (on file with author).

136 See Fogel, *supra* note 134, at 1503-04.

137 See, e.g., Voluntary Disclosure: Questions and Answers, *supra* note 132.

dividual taxpayers who are motivated by feelings of reciprocity. According to reciprocity theory, these types of taxpayers will comply with the tax system only if they believe that other taxpayers are paying their taxes honestly. Because tax privacy primarily causes individuals to see examples of tax enforcement that show the government catching tax cheats and subjecting them to harsh punishment, compliant individuals may perceive that few of their fellow taxpayers cheat and that those who do face dire consequences. Without tax privacy, visible examples of the government's failure to detect or penalize non-compliant taxpayers could appear and have negative tax-compliance effects on individuals whose voluntary compliance is conditional on that of other taxpayers.

6.2. *List of taxpayers*

The IRS does not publish lists of taxpayers and their respective tax liabilities. If a taxpayer is involved in a public civil or criminal trial with the government over tax matters, the public may learn about the taxpayer's return information. The government currently takes the position that, in these cases, it may publicly disclose information that has become part of a public court record.¹³⁸ Further, a taxpayer may enter into a civil settlement agreement with the IRS and, as part of the settlement, sign a waiver of the tax privacy protections described above.¹³⁹ And if a taxpayer is delinquent in paying federal income taxes, the government may file a Notice of Federal Tax Lien on the taxpayer's property, which publicly notifies the taxpayer's creditors of the government's claim.¹⁴⁰

At the state level, taxing authorities frequently publish the names of individual and business taxpayers are delinquent in paying taxes in excess of a specified threshold. Over half of the states in the United States have published the identities of businesses and individuals that have failed to pay outstanding tax liabilities on time. State taxing authorities most commonly use websites to publicize this information, such as Maryland's "Caught in the Web"¹⁴¹ and South Carolina's "Debtor's Corner."¹⁴² In most states, the mechanics of tax shaming campaigns are rela-

138 IRS, *supra* note 56, at 2-28. Although this issue has been disputed, several courts have sided with the government's position. See, e.g., *Lampert v. United States*, 854 F.2d 335, 337 (9th Cir. 1988) (citing several lower court decisions finding that tax information is no longer confidential once disclosed to a court).

139 See Treas. Reg. § 301.6103(c)-1(b) (2003), for a description of procedures that the IRS must follow in obtaining a waiver.

140 File a Notice of Federal Tax Lien, IRS, <http://www.irs.gov/businesses/small/article/0,,id=108339,00.html#Notice> (last updated 19 Dec. 2011).

141 Comptroller of Maryland, *Caught in the Web*, available at http://compnet.comp.state.md.us/Compliance_Division/Collections/General_Collections_Information/Caught_in_the_Web.Shtml. (2013).

142 South Carolina Dep't of Revenue, *Debtor's Corner*, at <http://www.sctax.org/delinquent/delinquent.shtml> (last visited 27 Sept. 2009).

tively simple. The state taxing authority identifies taxpayers who owe outstanding state tax liability in excess of a threshold amount. After there is no legal dispute as to the amount of outstanding tax liability, the Department of Revenue mails a “Notice of Pending Internet Posting” to these taxpayers warning them that if they do not make payment, their names and amounts of outstanding tax liabilities will be posted on the tax shaming website.¹⁴³ State revenue agencies report that taxpayers have responded positively to the threat of public shaming, as they have paid millions of dollars in outstanding taxes in recent years.

6.3. *Protection of journalist sources in the tax administration and tax courts*

While some jurisdictions may provide employees of the taxing authority with legal protections when they independently provide tax return information of specific taxpayers to the press, the United States does not provide such exemptions. Under Section 6103 of the Internal Revenue Code, employees of the IRS are prohibited from disclosing return information of specific taxpayers to non-authorized individuals, including members of the press.¹⁴⁴ However, the IRS may disclose taxpayer identity information to the press and other media solely for the purposes of notifying persons entitled to tax refunds when the IRS has been unable to locate such persons after a reasonable lapse of effort and time.¹⁴⁵

7. Access to taxpayers’ data by individuals

There are limited circumstances under which the public may gain access to a specific taxpayer’s federal tax return information.

The IRS provides private letter rulings to individual and business taxpayers under certain circumstances.¹⁴⁶ A “letter ruling” is a written determination issued to a taxpayer by the IRS in response to the taxpayer’s written inquiry, filed prior to the filing of its tax return.¹⁴⁷ A letter ruling interprets the tax laws and applies them to the taxpayer’s specific set of facts. After the IRS issues a private letter ruling to a taxpayer, it publishes the text of this ruling for public inspection.¹⁴⁸ When the IRS publishes the private letter ruling, however, it redacts all identifying information of the taxpayer that requested and received the ruling. As a result, the public may

143 Wis. Stat. § 73.03(62).

144 I.R.C. § 6103.

145 I.R.C. § 6103(m).

146 For an overview of the procedures related to the request and issuance of private letter rulings, see Internal Revenue Bulletin 2012-1 (Jan. 2, 2013), available at <http://www.irs.gov/pub/irs-irbs/irb13-01.pdf>. (2013).

147 See id.

148 I.R.C. § 6110.

view tax return information of a particular taxpayer, but it will likely be unable to determine with certainty the identity of that taxpayer.

It is also possible for a taxpayer to waive its tax privacy protections under Section 6103 of the Internal Revenue Code. Taxpayers occasionally grant the IRS this waiver in connection with the settlement of a significant tax controversy. During the tax shelter crackdown of the mid-2000s, the Chief Counsel of the IRS, Donald Korb, commented that when a corporation desired to settle a tax shelter dispute, he would “say okay, but as part of the settlement, we’ll put out a press release naming you.”¹⁴⁹ A press release may describe the corporation’s participation in an abusive tax shelter and the terms of the settlement, including the tax liability, penalties, and interest ultimately owed.¹⁵⁰

8. Consequences of Infringement

Individuals who make unauthorized disclosures of returns or return information may face civil penalties and criminal penalties of up to five years in prison.¹⁵¹ In addition, the Internal Revenue Code prohibits members of the Executive Branch from accessing tax return information or attempting to influence taxpayer audits or other investigations.¹⁵²

The consequences of infringement of tax privacy protections in the United States are illustrated through the hypothetical examples set forth below:

John A is an employee at the national tax administration. One day John is reviewing the tax declaration of Steven B, sole proprietor of a locally very popular furniture store, Smiling Homes. John discovers that during 2010 Smiling Homes has bought furniture from non-European companies known for their intense use of child labour. John decides to reveal this information to a local newspaper by sending a copy of Steven’s tax declaration (or a copy of both Steven’s and Smiling Homes’ declaration, if those are kept separate in your legal system). The newspaper publishes a series of articles on Steven B’s lack of social sensitivity. Steven, in the year following the revelations, experiences a sharp decrease in sales, estimated at EUR 500,000. Moreover, Steven and his family are regularly harassed by activists picketing in front of their home.

John A’s act of disclosure may result in the imposition of a criminal prison sentence of up to five years and a criminal fine of up to USD 5,000.¹⁵³ These conse-

149 Donald Korb, *The War on Tax Shelters*, Speech at NYU School of Law (6 Mar. 2007) (discussing IRS approach of releasing press releases regarding tax shelter settlements with large corporations) (notes on file with author).

150 See, e.g., Press Release, IRS, *IRS Accepts Settlement Offer on Contingent Liability Tax Shelter* (Dec. 16, 2004), available at <http://www.irs.gov/newsroom/article/0,,id=132350,00.html> (Hercules settlement).

151 IRC §§ 7431, 7213.

152 IRC § 7217.

153 IRC § 7213(a)(1).

quences occur because John A is an officer or employee of the IRS. Further, under the facts presented in this hypothetical, John A appears to have acted “wilfully” in disclosing the information regarding Steven’s business practices to a local newspaper. In addition, John A may be liable for civil damages if Steven decides to sue John A in US District Court.¹⁵⁴

Carl C is an employee of the national tax administration. On Monday, 1 June 2011, Carl receives a call from a police officer demanding that he sends over all the tax documentation pertaining to Sandra D. The officer explains that Sandra D is suspected of collaboration with terrorists. The requested tax documentation may help the police understand Sandra’s economic movements and her business connections. Of interest is also that the terrorist group to which Sandra may be connected is, according to intelligence information, planning an attack against a political target. Carl complies with the police officer’s request. After a few months, however, it becomes clear that Sandra D is not connected to a terrorist group and that all her business transactions are conducted with respectable persons. In particular, Sandra works as a translator from English to Arabic. Many of Sandra’s clients, however, decide to abandon her after having been contacted by the police during the investigation.

Carl C likely can rely on a special exception in the US federal tax law to avoid criminal prosecution or civil liability as a result of the disclosure of Sandra D’s tax return information to the law enforcement officer. The US Congress has enacted a special exception to Section 6103, which allows the IRS to disclose tax return information to other law enforcement agencies if the disclosure is relevant to any terrorist incident or threat.¹⁵⁵ Under this provision, the IRS may disclose in writing return information that may be related to a terrorist incident, threat, or activity to the extent necessary to apprise the head of the appropriate Federal law enforcement agency responsible for investigating or responding to such terrorist incident, threat, or activity.¹⁵⁶

Amanda F is an employee at Pecunia Bank located in Country A. On 3 May 2011 she is approached by a person, Henry G, an agent of Country A’s tax authority, who asks her to provide a memory stick containing information on all the bank’s account holders. Henry G claims that several citizens of Country B use Pecunia Bank’s accounts to screen their tax evasion and that the government of Country B has asked Country A for help in order to recover hundreds of millions of euros in taxes. Amanda agrees and downloads all the required information on a memory stick that she then gives to Henry G. The information is then provided to Country B’s tax authority.

Amanda F has not committed a criminal offense under Section 7213 of the Internal Revenue Code¹⁵⁷ because she is not an officer or employee of the United States. In addition, because the identity of the bank account holders is not “return infor-

154 IRC § 7431(a).

155 § 6103(i)(3).

156 See id.

157 IRC § 7213.

mation” under Section 6103,¹⁵⁸ the criminal sanctions that apply to John A above are not relevant to Amanda F.

Conclusion

This Report has provided an overview of tax privacy in the United States. By examining the relationship of individual tax privacy and individual tax compliance from a new perspective, this Report has offered a new defence of individual tax privacy: that tax privacy enables the government to influence individuals’ perceptions of its tax-enforcement capabilities by publicizing specific examples of its tax-enforcement strengths without exposing specific examples of its tax-enforcement weaknesses. The strategic-publicity function of tax privacy may facilitate the government’s deterrence efforts by causing individuals to overestimate the government’s ability to detect tax avoidance and evasion and to punish non-compliant taxpayers. Likewise, it may enable the government to increase confidence among compliant taxpayers, enriching feelings of reciprocity by causing them to perceive that most people pay their taxes honestly, even if this is not often—or ever—the case. This Report has shown that the strategic-publicity function of tax privacy likely encourages individuals to report their taxes properly and it has argued that this function should be exploited to enhance voluntary compliance.

158 IRC § 6103(b).