

Other Countries' Taxes on Value Added

The Hungarian HIPA tax, the Italian IRAP tax, and the French BCVA tax, along with the Michigan SBT and the proposed California BNRT, provide some useful information on value added taxation. Once a decision is made to impose a broad-based tax on consumption, there are some important details on how to structure the tax. These include the method of collection, information used to calculate taxes, definition of the tax base, and treatment of imports and exports. The table shows some of the similarities and differences between the European VATs and three of the countries' AVTs, plus the California BNRT proposal.

Implications

Broad-based consumption taxes can take many forms and have different labels. Depending on their specifics, a VAT is similar to a retail sales tax. A VAT can be administered with a transactions-based credit-invoice system or a entity-level subtraction-method system. Several U.S. proposals have called for subtraction-method VATs or a progressive consumption tax with a business cash flow tax combined with a progressive individual labor compensation tax. VATs can exempt or tax imports and exports and can expense or depreciate capital investments.

The fact that three European countries use two different taxes on a broad measure of value added indicates the range of possible VAT options available to U.S. policymakers. The ECJ's form over substance arguments and perceptions about the ultimate incidence of the taxes also suggest that the design and debate over alternative consumption taxes may affect their political prospects.

Requiem for Paper Information Statements

By Jay A. Soled

Jay A. Soled is a professor at Rutgers University Business School. This article is a synopsis of a longer piece on the same topic. See Jay A. Soled, "Call for the Gradual Phase-Out of All Paper Tax Information Statements," 10 *Fla. Tax Rev.* (forthcoming 2010).

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For nearly a century,¹ paper information statements such as forms W-2, 1098, and 1099 have played a critical role in facilitating code compliance. In the absence of those information statements, taxpayers would undoubtedly struggle to determine their tax obligations and likely underestimate the IRS's ability to monitor their compliance.² But like the steam locomotive, record player, and rotary telephone, paper information statements are a relic of a bygone era, and short of retaining them for nostalgic reasons, Congress should gradually eliminate them.

¹Act of October 3, 1917, P.L. 50, ch. 63, section 28, 40 Stat. 300, 337; see Richard L. Doernberg, "The Case Against Withholding," 61 *Tex. L. Rev.* 595, 599-603 (1982) (detailing the history of information returns and statements).

²See Government Accountability Office, "Tax Administration: Costs and Uses of Third-Party Information Returns," GAO-08-266 (Nov. 20, 2007), *Doc 2007-27904*, 2007 TNT 246-30, available at <http://www.gao.gov/new.items/d08266.pdf> (report reflects the effectiveness of information returns in ensuring taxpayer compliance); IRS, "IRS Releases Fact Sheet on Third-Party Reporting," FS-2006-24 (Aug. 31, 2006), *Doc 2006-19139*, 2006 TNT 177-12 ("Experience shows that taxpayers are much more likely to report their income when they receive third-party notification of payments they received."); GAO, "Tax Gap: Many Actions Taken, but a Cohesive Compliance Strategy Needed," GAO/GGD 94-123, at 5 (May 11, 1994), available at <http://archive.gao.gov/t2pbat3/151585.pdf> ("Information returns are a proven way to promote compliance and help IRS find noncompliance."); Michael C. Durst, "Report of the Second Invitational Conference on Income Tax Compliance," 42 *Tax Law.* 705, 709 (1989) ("Computer-based enforcement techniques, relying largely on information returns filed by payers of wages, interest, dividends, and other items, have provided valuable benefits by virtually eliminating noncompliance with respect to important categories of income."); see also Leandra Lederman, "Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance," 60 *Stan. L. Rev.* 695, 695 (2007) ("Third parties are routinely used by the tax system to verify the bona fides of taxpayer claims in diverse contexts involving reimbursed amounts and other receipts.").

Calling for the elimination of something that has such a proven track record requires an explanation. For starters, the issuance of paper information statements creates a tremendous duplication of effort: taxpayers receive the information, transcribe it onto their tax returns, and then submit those returns to the IRS. That three-step process is a time-consuming and resource-intensive endeavor that, when distilled down to its fundamentals, provides the IRS with essentially the same information that it already possesses via tax information returns submitted by third parties.³ Second, in our technological age, supplying information on paper is not cost-effective, particularly when the identical information could be readily accessed through an electronic medium and then much more easily manipulated to conform to tax return submission requirements. Finally, over the past several years, the number and types of paper information statements that taxpayers receive have skyrocketed; and in the coming years, all indications are that this trend will continue.⁴ However, those information statements are easily lost or misplaced, can flummox taxpayers with their numerous numeric entries and special codes, and probably constitute enough timber pulp to supply most public high schools throughout the country with their annual paper supply.

But simply eliminating paper information statements is not advisable. Instead, along with eliminating paper information statements, Congress should require that the data collected from tax information returns be made available to taxpayers via the Internet. Were that requirement instituted, here's a vision of what would likely ensue: On or before January 31, responsible third parties who have traditionally issued paper information statements will instead electronically send pertinent tax information (for example, employees' wages, withholding data, interest payments, and the amount of recognized gains and losses on marketable securities) to the IRS via tax information returns. The IRS will then store that information, encrypt it, and post it on the Internet no later than February 14. Beginning on February 15, from a

secure IRS website, using a personal identification number, taxpayers will access that information, review it, and then download it instantaneously onto their income tax returns from a secure site.⁵ While data aggregation of the sort envisioned here would not generate a tax compliance utopia, it would be a tremendous step in the right direction.

Some forward-thinking politicians see the vision depicted in the prior paragraph as immediately viable.⁶ The reason for their optimism is neither misplaced nor misguided: the rapid pace of technological changes, coupled with ordinary taxpayers' familiarity with computer usage and the Internet, signifies that our tax system is poised for change.⁷ Just a decade ago, who would have imagined that more than 70 percent of the nation's individual income tax returns would be filed electronically⁸ and that tax software packages would enjoy such widespread popularity?⁹ The answer is politicians with vision and foresight. And it is those same politicians (and their staff members) who can lead our tax system out of the 20th century and into the 21st.

For a moment, consider the benefits that would inure to taxpayers, third-party information providers, accountants, and the government were Congress to mandate electronic data access. Taxpayers would be able to download all the relevant tax information onto their tax returns, saving them a tremendous amount of time and expense; indeed, with a few keystrokes, after downloading, the vast majority of taxpayers could complete their tax returns in a matter of minutes. The workload of

⁵Rep. Bill Foster, D-Ill., has recently introduced legislation that in many respects mirrors this proposal. Foster's proposed legislation, the Autofile Act of 2010, would require the IRS to allow taxpayers to visit the IRS website and gain electronic access to their personal tax data. See H.R. 5050, 111th Congress, 2d Sess. (2010).

The government has an analogue of this proposal already in place known as the electronic federal tax payment system (EFTPS). As described in congressional testimony, "EFTPS enables businesses, including clients of such agents, to view their tax account online via a secure Internet connection. Clients can confirm that tax payments have been received by the IRS and posted to their account as soon as the day after the tax deposit due date." "Streamlining Tax Administration: How the IRS Can Streamline Its Own Processes and Decrease Taxpayer Burden" (Feb. 1, 2005) (testimony for the IRS Oversight Board), available at <http://www.treas.gov/irsob/meetings/2-01-05/statement-nprc.pdf>.

⁶*Id.*

⁷See Section III in Jay A. Soled, "Call for the Gradual Phase-Out of All Paper Tax Information Statements," 10 *Fla. Tax Rev.* (forthcoming 2010).

⁸See GAO, "GAO Analyzes Results of IRS 2009 Filing Season," GAO-09-640 (June 3, 2009), *Doc 2009-12670*, 2009 TNT 106-25 (reporting for the 2009 tax return filing season that 72 percent of returns were filed electronically); IRS Data Book, 2009, Publication 55B, table 4, at 9 (reflecting the fact that the majority of individual, corporate, and partnership tax returns are now all filed electronically).

⁹See GAO, "GAO Says IRS Should Assess Risks of Tax Return Preparation Software," GAO-09-297 (Apr. 3, 2009), *Doc 2009-7539*, 2009 TNT 62-29. ("Individual taxpayers used commercial tax software to prepare over 39 million tax returns in 2007.")

³Austan Goolsbee, "Why Tell the IRS What It Already Knows?" *The New York Times* (Apr. 6, 2007), available at <http://www.nytimes.com/2006/04/07/opinion/07goolsbee.html>.

⁴See, e.g., Patient Protection and Affordable Care Act of 2010, P.L. 111-148, 124 Stat. 119, section 9006 (beginning in 2012, companies will be required to furnish and file Form 1099-MISC for payments aggregating \$600 or more in a calendar year made to all for-profit companies). In recent congressional testimony, Shulman targeted six new areas of information reporting:

- requiring information reporting for private separate accounts of life insurance companies;
- requiring information reporting on payments for services to corporations;
- requiring certified taxpayer identification numbers from contractors;
- requiring increased information reporting on some government payments;
- increasing information return penalties; and
- requiring information reporting on expense payments relating to rental property.

"Shulman Testifies on Plans to Improve Tax Compliance, Target Tax Gap," *Doc 2010-6529*, 2010 TNT 58-25 (Mar. 26, 2010).

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third-party information providers would literally be cut in half as they would now only have to produce tax information returns rather than having to prepare and distribute both returns and tax information statements. Seasoned accountants, too, would no longer have to endure the menial chore of making numeric data entries. Finally, because taxpayers would probably commit far fewer clerical mistakes, the IRS would likely conduct fewer correspondence audits,¹⁰ enabling it to fulfill other oversight responsibilities.

This is not to say that the elimination of paper information statements combined with electronic data access would occur without glitches. To date, the IRS has had a lackluster record of making technological changes,¹¹ which does not bode well for making the transition to granting taxpayers electronic access. Further, some taxpayers may use the electronic access medium as an opportunity to underreport their income (that is, taxpayers may equate the IRS's lack of information as an excuse not to report income). Finally, while computer usage is fairly widespread, there are still those taxpayers, particularly the elderly and the impoverished, who may not have computer access or be familiar with the Internet.

But those anticipated glitches can be overcome. For example, despite its prior problems, the IRS has made several recent strides in improving its technological savvy.¹² Insofar as compliance issues are concerned, the

IRS would have to be vigilant to ensure that taxpayers did not use electronic data access as an excuse for noncompliance.¹³ Finally, to ensure universal computer access, Congress would have to make special provisions to enable all taxpayers to have computer access (say, by enlarging the supply of computers at public libraries or at IRS service centers); alternatively, Congress could permit those taxpayers without computer access to continue to receive their paper information return statements.

* * *

In the end, there is no need to shed tears for eliminating the century-old tradition of using tax information statements to complete tax returns. We can extol paper information statements for keeping the nation on a sound financial footing¹⁴ and for the ease they brought taxpayers in fulfilling their civic duty of tax return completion.¹⁵ But what we shouldn't do is keep them on perpetual life support as they sap our nation of vital

body for all matters relating to security and privacy issues in the IRS. It has made steady progress each year in complying with the requirements of the Federal Information Security Management Act. In addition, IRS has established an office of Privacy, Information Protection and Data Security to: (1) improve public, preparer and external stakeholder awareness of privacy policies, procedures, and general information, and (2) improve the IRS response to taxpayers and practitioners who fall victim to data loss incidents, identity theft, or online fraud.

See also GAO, "Information Security: IRS Needs to Continue to Address Significant Weaknesses," GAO-10-355, at 5 (Mar. 2010), *Doc 2010-6069*, 2010 TNT 54-57, available at <http://cryptome.org/gao-10-355.pdf>. ("During fiscal year 2009, IRS has made progress toward correcting previously reported information security control weaknesses and information security program deficiencies at its three computing centers, another facility, and enterprisewide.")

¹³This is virtually identical to the complaint initially lodged against the ReadyReturn program instituted in California. See Joseph Bankman, "Simple Filing for Average Citizens: The California ReadyReturn," *Tax Notes*, June 13, 2005, p. 1431, *Doc 2005-11952*, or 2005 TNT 113-33 (providing a complete overview of how the ReadyReturn program is designed to operate). The ReadyReturn program involved the state of California completing and disseminating state income tax returns to California residents who met the criteria (*i.e.*, those who did not itemize and had wage income only). Recipients of the returns could ignore them, adjust them, or sign and submit them. Despite the fear that California taxpayers who earned income beyond that reflected on the proposed state income tax return would not be forthcoming about the receipt of other income, in the vast majority of cases, the Legislature's compliance fears proved unfounded. See Franchise Tax Board Report to the Legislature (Apr. 23, 2009), available at <http://www.ftb.ca.gov/readyReturn/ReadyReturnReport2009.pdf> (in this report, there is no mention that taxpayer compliance suffered as a result of the program being instituted).

¹⁴Jay A. Soled, "Homage to Information Returns," 27 *Va. Tax L. Rev.* 371 (2007).

¹⁵See Lawrence Zelenak, "Justice Holmes, Ralph Kramden, and the Civic Virtues of a Tax Return Filing Requirement," 61 *Tax L. Rev.* 53 (2007) (expounding the civic virtues associated with the process of taxpayers fulfilling their obligations under the code and submitting their tax returns to the government).

¹⁰Correspondence audits are conducted through what is known as the automated underreporter program, which detects flawed tax returns when taxpayers either inadvertently omit tax data or err in reporting the data. See, *e.g.*, John L. Miller, "The IRS Underreporter Initiative," *The Tax Advisor* 49 (Jan. 2009). ("The automated underreporter program, which affects 4-5 million taxpayers annually, starts with third-party information returns filed with the IRS by employers, banks, and brokers. The Service matches the amounts reported on the individual and the information returns and creates an inventory of the resulting mismatches.")

¹¹Through its Electronic Tax Administration Advisory Committee, the IRS seems to be exploring ways to expand the use of computer applications to the tax filing process. Nevertheless, there are apparently no plans to make tax data available to taxpayers so that they could complete the submission of their tax returns on a timely basis. IRS Publication 3415, *Electronic Tax Administration Advisory Committee Annual Report to Congress* (June 2010), available at <http://www.irs.gov/pub/irs-pdf/p3415.pdf>. On at least one occasion, however, the IRS did consider providing taxpayers with access to collected tax data, but that effort was later abandoned. See Treasury Inspector General for Tax Administration, "Changing Strategies Led to the Termination of the My IRS Account Project," 2009-20-102 (Aug. 12, 2009), *Doc 2009-20060*, 2009 TNT 172-58, available at <http://www.treas.gov/tigta/auditreports/2009reports/200920102fr.pdf>. ("The intent of the project was to develop a project that would provide taxpayers a means to securely view their tax account and return information online, as well as provide tools for self-service assistance.")

¹²See, *e.g.*, José E. Serrano, D-N.Y., "House Appropriations Committee Releases Report for Fiscal 2010 Financial Services Spending Bill," *Doc 2009-16032*, 2009 TNT 134-16 (July 15, 2009):

The IRS has taken several important steps to protect taxpayer data. For example, as TIGTA notes, it has established a Security Services and Privacy Executive Steering Committee to serve as the primary governance

(Footnote continued in next column.)

resources that we can ill afford to pay. It's time to inter paper information statements and let their memories inspire us to realize a fundamental national goal: a tax system in which administrative ease reigns and, as a corollary, taxpayer compliance remains high.



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