

# ARTICLE

## TIME FOR A TAX RETURN FILING FEE

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### ABSTRACT

*The IRS faces the monumental task of verifying, to the extent possible, the items reported on the hundreds of millions of tax returns filed each year. It does so with meager and shrinking resources. Some taxpayers burden the filing system more than others. At one extreme, a taxpayer who earns only income that is subject to third-party reporting and withholding and who claims the standard deduction adds very little to the IRS's burden. At the other end of the extreme, a large business engaged in numerous complex transactions demands significant resources if that taxpayer's claimed tax outcomes are fully examined. In light of this landscape, this Article makes the novel proposal that Congress require payment of a tax return filing fee by some taxpayers. The amount of the fee would vary based on some of the factors that make each taxpayer more or less difficult to audit, with carveouts for difficult-to-audit items that are disproportionately claimed by lower-income individuals.*

*The goals of the proposal are three: first, to make the system fairer; second, to raise additional revenue; and third, to improve efficiency by encouraging taxpayers to take into account the costs imposed on the tax administration system by their complex transactions.*

### TABLE OF CONTENTS

I.	INTRODUCTION .....	104
II.	IRS RESOURCE CONSTRAINTS .....	108
III.	DIFFERENCES IN BURDEN ON THE IRS .....	110
	A. <i>Different Types of Income</i> .....	111
	B. <i>Different Deductions</i> .....	113
	C. <i>Differences in Complexity of Transactions</i> .....	115
IV.	THE TAX RETURN FILING FEE PROPOSAL .....	118
	A. <i>A Tax Analogue: The Letter Ruling Request Fee</i> .....	118
	B. <i>Non-Tax Fee Analogies</i> .....	122
	C. <i>Necessity for the Tax Return Filing Fee</i> .....	124
	D. <i>Design Considerations</i> .....	126
	1. <i>Charging Higher Fees for More Difficult to Audit Taxpayers</i> .....	126

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2.	<i>Avoiding Regressivity</i> .....	127
3.	<i>Promoting Administrability</i> .....	128
4.	<i>Avoiding the Exacerbation of Underreporting by Taxpayers</i> .....	131
5.	<i>Guarding Against Reverse Engineering</i> .....	134
6.	<i>Bolstering Political Feasibility</i> .....	135
7.	<i>Summary</i> .....	136
V.	REASONS TO ADOPT A TAX RETURN FILING FEE.....	136
A.	<i>Fairness</i> .....	136
B.	<i>Revenue</i> .....	138
C.	<i>Efficiency (To a Lesser Degree)</i> .....	140
VI.	CONCLUSION .....	142

## I. INTRODUCTION

The Internal Revenue Service (“IRS”)—tasked with ensuring that individuals and businesses comply with applicable tax law and pay the appropriate amount of tax liability—has been increasingly deprived of the resources needed to do its job. In 2018, the IRS’s total operating costs were \$11.7 billion, compared to total 2009 operating costs of \$13.7 billion.<sup>1</sup> In 2018, the IRS employed the equivalent of 73,519 full-time individuals, many fewer than the 92,577 individuals the IRS employed in 2009.<sup>2</sup> The deprivation of resources has had a number of effects, and the press has noticed. For instance, in 2018, the *New York Times* reported that IRS budget cuts have resulted in the IRS pursuing fewer tax evasion cases.<sup>3</sup> In 2019, a *Washington Post* editorial identified the declining audit rate for high income individuals and the declining overall audit rate as consequences of the IRS’s shrinking budget.<sup>4</sup>

Even when the IRS’s resources are more robust, taxpayers, on the whole, do not pay all taxes owed. The IRS periodically estimates the “tax gap”—the difference between what taxpayers do pay in taxes and what they should pay in taxes. For the 2011 to 2013 time period, the IRS estimates an average annual tax gap of \$441 billion.<sup>5</sup> Of that amount, the IRS estimates

<sup>1</sup> The \$13.7 billion figure is inflation adjusted into equivalent 2018 dollars. INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK 2019, at 74 (2020), <https://www.irs.gov/pub/irs-pdf/p55b.pdf> [<https://perma.cc/R2N8-H7EK>].

<sup>2</sup> *Id.*

<sup>3</sup> Jesse Eisinger & Paul Kiel, *I.R.S. Tax Fraud Cases Plummet After Budget Cuts*, N.Y. TIMES (Oct. 1, 2018), <https://www.nytimes.com/2018/10/01/business/economy/irs-tax-fraud-audit.html> [<https://perma.cc/8CYQ-Q3UD>].

<sup>4</sup> Editorial, *The IRS Cannot Keep Trying to Do More with Less*, WASH. POST (May 28, 2019, 6:57 PM), [https://www.washingtonpost.com/opinions/the-irs-cannot-keep-trying-to-do-more-with-less/2019/05/28/1b3122d4-7caa-11e9-8bb7-0fc796cf2ec0\\_story.html](https://www.washingtonpost.com/opinions/the-irs-cannot-keep-trying-to-do-more-with-less/2019/05/28/1b3122d4-7caa-11e9-8bb7-0fc796cf2ec0_story.html) [<https://perma.cc/KMG5-3HU5>].

<sup>5</sup> BARRY W. JOHNSON ET AL., INTERNAL REVENUE SERV., FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013, at 1 (2019), <https://www.irs.gov/pub/irs-pdf/p1415.pdf> [<https://perma.cc/Q8QS-6UWQ>].

that it will eventually collect \$60 billion via enforcement action, resulting in an estimate of \$381 billion each year of taxes owed that will never be paid.<sup>6</sup> As a result of the tax gap, a recent study projects that, between 2020 and 2029, the IRS will fail to collect a total of close to \$7.5 trillion in taxes that are owed.<sup>7</sup> Tax gap estimates sometimes attract the attention of the press and lawmakers who advocate for reducing the tax gap as a politically appealing way to collect additional tax revenue.<sup>8</sup> Politicians and others have observed that closing the tax gap could fund a significant portion of the federal budget or lessen the tax burden imposed upon compliant taxpayers.<sup>9</sup>

When it comes to auditing taxpayers, different taxpayers demand widely varying levels of effort from the IRS. The cost of auditing any given taxpayer depends on many factors, including the types of income earned by the taxpayer, the deductions claimed by the taxpayer, and the number and complexity of the taxpayer's transactions.

Existing literature, in other contexts, analyzes the use of government user fees and assesses their pros and cons.<sup>10</sup> A separate body of literature discusses the tax gap and potential approaches for narrowing it.<sup>11</sup> This Article draws upon these existing strands of literature and makes the novel proposal for Congress to institute a tax return filing fee.

In particular, to address the IRS's limited resources and the varying difficulty of auditing different taxpayers, this Article proposes imposing a tax return filing fee on some taxpayers. The fee would vary based on certain specified facts about the taxpayer's return with the general aim of charging a

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<sup>6</sup> *Id.*

<sup>7</sup> Natasha Sarin & Lawrence H. Summers, *Shrinking the Tax Gap: Approaches and Revenue Potential* (Nat'l Bureau of Econ. Research, Working Paper No. 26,475, 2019), <https://www.nber.org/papers/w26475.pdf> [<https://perma.cc/Z3LK-T4UE>].

<sup>8</sup> See, e.g., Dennis J. Ventry, Jr., *Cooperative Tax Regulation*, 41 CONN. L. REV. 431, 433–34 (2008) (“Baucus and others urged the Bush administration to move aggressively, and to rework preliminary proposals which were forecast to net \$3.5 billion over ten years, just one-tenth of one percent of the estimated \$3.5 trillion tax gap. A slew of recommendations sprung forth. The Bush administration offered sixteen new legislative proposals to implement the Treasury Department’s ‘comprehensive, integrated, multi-year strategy’ to close the tax gap. At the same time, legislators introduced more than a dozen tax gap bills. Closing the gap became a priority for the IRS and a bipartisan issue for Congress.”). Political appeals to reduce the tax gap sometimes have the negative effect of excusing the failure to raise money by other means. See Bret Wells, *Voluntary Compliance: “This Return Might Be Correct But Probably Isn’t,”* 29 VA. TAX REV. 645, 648 (2010) (“[M]any in Congress argue the tax gap should be reduced before any other revenue-raising proposals are considered.”).

<sup>9</sup> See Danshera Cords, *Tax Protestors and Penalties, Ensuring Perceived Fairness and Mitigating Systemic Costs*, 2005 BYU L. REV. 1515, 1521–22 (2005) (“[T]he tax gap is approximately equal to the amount that the federal government pays each year for Medicare or the 2005 federal budget deficit. Examined another way, the tax gap increases the tax burden on every compliant individual taxpayer by \$2,000.”); Ventry, *supra* note 8, at 433–34 (“The revenue to be gained from closing the tax gap was ‘low-hanging fruit,’ according to Charles Rangel (D-NY). It could eliminate the deficit, pay for revising the Alternative Minimum Tax, and reform the health care system.”).

<sup>10</sup> See *infra* notes 96–99, 107, 108, 116, 142, 145, 147–52.

<sup>11</sup> See *infra* note 28.

higher fee in cases in which auditing the taxpayer would be more onerous.<sup>12</sup> Congress would specify the method for determining the fee rather than leaving the determination to the IRS.<sup>13</sup> At least initially, the fee would be based upon the number of tax positions reported on Schedule UTP, a schedule certain large companies must file with their tax returns containing information about their uncertain tax positions.<sup>14</sup> The transactions reported on Schedule UTP will generally be transactions that yield tax consequences that the taxpayer estimates are not “more likely than not” to be upheld if fully vetted.<sup>15</sup>

There are several advantages to a tax return filing fee. First, such a fee promotes fairness by requiring those who disproportionately burden the IRS to pay more for the additional costs they impose. Furthermore, limiting the scope of the fee to transactions reported on Schedule UTP ensures that the fee applies in contexts in which the taxpayer takes a tax position that, in the taxpayer’s estimation, does not meet the threshold of being “more likely than not” to be upheld if evaluated on the merits. Often, taxpayers will have designed such transactions in an attempt to obtain tax consequences that may be more favorable than what lawmakers intended.<sup>16</sup> Thus, the difficulty of auditing such transactions is taxpayer created, bolstering the fairness justification for requiring the taxpayer to pay for the resulting burden imposed on the IRS. Even if the fee were expanded beyond this initial scope, it would generally fall on higher-earning taxpayers because they are more likely to engage in complex transactions and take other positions that are more difficult to audit. In addition, the proposal exempts from its scope certain items disproportionately claimed by lower-income individuals. To the extent that the tax system is progressive (meaning higher-income taxpayers are already subject to higher tax rates), it might be tempting to assume that a tax return filing fee is unnecessary because we can simply rely on progressive tax rates to achieve the same outcome. However, many of the very things that make higher-earning taxpayers more difficult to audit (e.g., engaging in complex transactions with uncertain tax outcomes) are the same things that reduce their effective tax rates. Thus, higher-earning taxpayers may not actually

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<sup>12</sup> This is subject to certain exceptions where other policy objectives would necessitate not increasing the fee as a result of increased audit costs. For instance, an additional fee would not be levied for difficult-to-audit items that are disproportionately claimed by lower-income taxpayers. See *infra* Part IV.D.2.

<sup>13</sup> As discussed in detail below, initially, the fee could be limited to taxpayers who file Schedule UTP and based upon the number of transactions reported on that schedule. The fee might be expanded beyond that category but it would always be determinable automatically based on items reported on a return and not variable based on IRS discretion. For discussion of the reasons for not allowing the fee to vary based on the IRS’s discretion, see *infra* note 118. For more detailed discussion of the design of the fee, see *infra* Part IV.D.

<sup>14</sup> See *infra* note 62 and accompanying text.

<sup>15</sup> See *infra* notes 62–66 and accompanying text.

<sup>16</sup> See *infra* note 67 and accompanying text.

bear an additional tax burden that is commensurate with the additional auditing burden they impose.

Second, a tax return filing fee would generate additional revenue, at least some of which could be used to fund the IRS.<sup>17</sup> Third, to a lesser degree, a filing fee may have some efficiency benefits. For instance, by prompting taxpayers to take into account the costs that their complex transactions impose upon the tax administration system, a filing fee might discourage some transactions that are not justified (but for their tax consequences).<sup>18</sup>

A tax return filing fee may, at first, seem like an unusual concept. However, analogies exist—both in the tax context and beyond—that entail levying fees upon individuals and businesses to defray costs they impose upon regulators.<sup>19</sup> In the tax arena, for instance, a taxpayer who plans to engage in a transaction with uncertain tax consequences can, in some instances, seek a letter ruling from the IRS that provides some certainty regarding the transaction's tax consequences.<sup>20</sup> Taxpayers who seek letter rulings must pay fees to the IRS in most cases.<sup>21</sup> At first glance, a tax return filing fee may seem quite different from a letter ruling request fee. However, for reasons discussed in detail below, the differences are less significant than they may, initially, appear.<sup>22</sup>

The remainder of this Article proceeds as follows. Part II provides additional background regarding existing IRS resource constraints, and Part III describes, in more detail, the factors that cause the costs of audit to vary across different taxpayers. Part IV sets forth this Article's proposal in more detail, discusses existing analogies (including the letter ruling request fee), and describes the design choices that Congress ought to make to ensure that the fee: (1) generally increases with the difficulty of auditing a taxpayer; (2) is not regressive (that is, it does not represent a higher percentage of the income earned by individuals with lower incomes); (3) is administrable; (4) does not exacerbate underreporting by taxpayers; (5) is not viewed by taxpayers as indicative of the likelihood of audit; and (6) is politically feasible. Finally, Part V discusses reasons to adopt the tax return filing fee proposal.

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<sup>17</sup> Regarding the extent to which amounts raised by the fee would be earmarked for the IRS, see *infra* notes 147–50 and accompanying text.

<sup>18</sup> The overall effect on efficiency is unclear, however, because the return filing fee could also discourage taxpayers from engaging in transactions that are beneficial. See *infra* Part V.C; *infra* note 155. In any event, efficiency is not the primary motivation for the tax return filing fee proposal.

<sup>19</sup> For discussion of other analogies, see *infra* notes 70–99 and accompanying text.

<sup>20</sup> For further discussion, see *infra* notes 70–72 and accompanying text.

<sup>21</sup> For further discussion, see *infra* notes 73–77 and accompanying text.

<sup>22</sup> For further discussion, see *infra* notes 79–93 and accompanying text.

## II. IRS RESOURCE CONSTRAINTS

From 2009 to 2018, the IRS's operating budget declined by 14.6%, and its staff shrunk by 20.6%.<sup>23</sup> Fewer people and less money make it more difficult for the IRS to do an already difficult job.<sup>24</sup> One consequence of budget cuts is lower audit rates. In 2018, the IRS audited 0.5% of all returns filed,<sup>25</sup> significantly less than the 0.9% audited in 2009.<sup>26</sup> Moreover, it appears that

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<sup>23</sup> See *supra* notes 1, 2, and accompanying text (reporting a budget decline from \$13.7 billion to \$11.7 billion, which represents a decline of 14.6%, and a staff that shrunk from 92,577 to 73,519, which translates into a decline of 20.6%). For discussion of some of the possible reasons behind the budget declines, see, for example, Jonathan Barry Forman & Roberta F. Mann, *Making the Internal Revenue Service Work*, 17 FLA. TAX REV. 725, 770–72 (2015) (“Many in the private sector also lament the underfunding of the IRS. For example, in a letter to members of the House and Senate Appropriations Committees, the Chair of the Section of Taxation of the American Bar Association wrote that ‘the recent trend of funding reductions for the [IRS] is negatively impacting its ability to properly serve taxpayers and enforce the tax laws that Congress enacts.’ The American Institute of Certified Public Accountants has expressed similar concerns. Pulitzer Prize-winning journalist David Cay Johnston has noted that ‘it makes no economic sense to trim the ranks of auditors who generate [revenues of] more than 100 times their annual salaries.’ Professor Diane Fahey notes that since the first enactment of the income tax, financial elites who recognized that restricting government funding would reduce the federal government’s influence and power have acted to undermine the income tax and the government’s ability to collect it. Whatever the motivation for the recent budget cuts was, the IRS has a big job to do and less and less money to do it with.”); Diane L. Fahey, *The Movement to Destroy the Income Tax and the IRS: Who Is Doing It and How They Are Succeeding*, 15 FLA. TAX REV. 157 (2014).

<sup>24</sup> See Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 UCLA L. REV. 1629, 1644 (2009) (“The IRS’s limited funds have, in recent years, forced field agents of the IRS’s Large and Midsize Business Division to reduce the length of audits of large corporate and other business taxpayers. . . . And despite the IRS’s description of the Office of Tax Shelter Analysis as a sophisticated command-and-control center capable of reviewing thousands of taxpayer and advisor disclosure statements, its staff, according to public reports, is of surprisingly modest size. Describing the challenges that this unit faces at a U.S. Senate hearing in 2003, Calvin Johnson colorfully testified, ‘I doubt their total annual budget would cover the annual Holiday Parties for the Skunk Works factories they are competing against.’”); Forman & Mann, *supra* note 23, at 767–68 (“While the IRS has been able to use increased electronic filing of tax returns, web-based services, and automation to become more efficient, those improvements have not been enough to offset the recent cuts in the IRS’s budget and personnel. Unquestionably, the declines in personnel and resources have led to a decrease in the number of returns examined, and most examinations are now conducted by correspondence (rather than in face-to-face audits.)”); Ventry, *supra* note 8, at 455–56 (“Viewed historically, the modern Internal Revenue Service is a shadow of its former self. During the ‘golden age’ of the IRS in the 1960s, audit levels approached an astonishing 6%. The Service recruited young lawyers from top law schools, entry-level salaries for government lawyers competed with private-sector wages, and IRS employees garnered respect from taxpayers, practitioners, and politicians. In every category, the golden years are a distant memory. Audit levels have fallen to 1%; newly-minted Harvard law graduates choose Wall Street firms with \$160,000 starting salaries and \$30,000 bonuses over positions at the IRS for one-fourth to one-third the remuneration . . . .”).

<sup>25</sup> INTERNAL REVENUE SERV., PUB. NO. 55B, DATA BOOK, 2018, at 23 tbl.9a (2019), <https://www.irs.gov/pub/irs-prior/p55b--2019.pdf> [<https://perma.cc/8NUY-U2BS>].

<sup>26</sup> INTERNAL REVENUE SERV., PUB. NO. 55B, DATA BOOK, 2009, at 22 tbl.9a (2010), <https://www.irs.gov/pub/irs-soi/09databk.pdf> [<https://perma.cc/7ZAP-RWGC>].

the decline in resources has had a correspondingly detrimental effect on the ability of the IRS to collect additional tax revenue through audit.<sup>27</sup>

Even when the IRS is not faced with a budget as lean as in recent years, the government does not collect all taxes owed. Periodic estimates of the tax gap show that taxpayers do not pay in taxes all that they should.<sup>28</sup> The IRS estimates an average annual net tax gap over the 2011 to 2013 time period of \$381 billion each year that is owed but will never be paid.<sup>29</sup> The tax gap arises from three general sources: (1) failure to file required returns on time; (2) understatement of the amount of tax owed on returns filed; and (3) failure to pay all tax reported to be due in a timely manner.<sup>30</sup> The method for estimating the tax gap varies across these components.<sup>31</sup>

In addition to periodic estimates of the tax gap, other available data bolster the conclusion that the government is leaving money on the table.

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<sup>27</sup> See, e.g., Sarin & Summers, *supra* note 7 (“One might argue that a reduction in enforcement resources is benign for multiple reasons. First, it is plausible that as technological developments have made the IRS more efficient, such that it no longer needs large outlays to police tax evasion. Second, if the IRS successfully targets resources towards examining the most egregious tax evaders’ returns, then a steep decline in the share of audits performed will have a much lesser impact on audit revenue. The fact that we observe an essentially 1:1 relationship between the resources that the IRS has at its disposal and the revenue generated from examination casts doubt on these theories. . . . [S]ince 2011, the share of returns audited (across all filing categories) fell by 45 percent, and the additional taxes collected from audits fell by nearly 50 percent.”).

<sup>28</sup> For additional discussion of the tax gap, see, for example, James Alm & Jay A. Soled, *W(h)ither the Tax Gap*, 92 WASH. L. REV. 521 (2017); Joseph Bankman, Clifford Nass & Joel Slemrod, *Using the Smart Return to Reduce Evasion and Simplify Tax Filing*, 69 TAX L. REV. 459 (2016); Leslie Book, *Refund Anticipation Loans and the Tax Gap*, 20 STAN. L. & POL’Y REV. 85 (2009); Danshera Cords, *Targeting the Tax Gap: The Case of the RAL and the Advanced Notice of Proposed Rulemaking*, 20 STAN. L. & POL’Y REV. 119 (2009); Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1734–35 (2010); Susan Cleary Morse, *Using Salience and Influence to Narrow the Tax Gap*, 40 LOY. U. CHI. L.J. 483 (2009); Susan Cleary Morse, Stewart Karlinsky & Joseph Bankman, *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL’Y REV. 37 (2009); Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL’Y REV. 7 (2009); Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUM. L. REV. 569, 574–75 (2006); Dave Rifkin, *A Primer on the Tax Gap and Methodologies for Reducing It*, 27 QUINNIPIAC L. REV. 375 (2009); Mildred Wigfall Robinson, *The States’ Stake and Role in Closing the Federal Tax Gap*, 28 VA. TAX REV. 959 (2009); Joel Slemrod et al., *Does Credit-Card Information Reporting Improve Small-Business Tax Compliance?*, 149 J. PUB. ECON. 1, 1 (2017); Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSP. 25, 26–29 (2007); Sarin & Summers, *supra* note 7; Ventry, *supra* note 8, at 433–36; Wells, *supra* note 8, at 647–49.

<sup>29</sup> See *supra* note 6 and accompanying text.

<sup>30</sup> JOHNSON ET AL., *supra* note 5, at 4.

<sup>31</sup> *Id.* at 13 (2019) (“There is no single method for estimating all the components of the tax gap. Rather, the approach for each component varies according to the type of information available.”). In general terms, the underreporting component of the tax gap is estimated based on analysis of information gathered from returns that the IRS audits and statistical techniques intended to estimate additional underreporting not detected on audit. *Id.* at 16–25. The second component of the tax gap (the part attributable to underreporting) is estimated to be the largest. In the most recent IRS estimate, for instance, of the \$441 billion gross tax gap, \$39 billion represents non-filing, \$352 billion represents underreporting, and \$50 billion represents underpayment. *Id.* at 8.

Sophisticated taxpayers claim tax outcomes that likely would not survive challenge if they were discovered and fully vetted. However, because their claimed tax outcomes are, in fact, not fully vetted in many cases, taxpayers end up paying less than what they would likely owe if the positions they take were fully examined and litigated. Reporting required of public companies sheds a bit of light on the extent to which this occurs. In particular, the Financial Accounting Standards Board issued Financial Interpretive Statement 48 (referred to as “FIN 48”), which contains various reporting requirements for public companies.<sup>32</sup> Among other things, FIN 48 provides that, if a domestic public company determines that a tax position that it claims is not “more likely than not” to be upheld on the merits, the company must set aside reserves to cover the possibility that the IRS could successfully challenge the position and impose additional tax liability.<sup>33</sup> In the company’s financial statement footnotes, the company must disclose the total amount of its tax reserves.<sup>34</sup> Examining the publicly disclosed amount of tax reserves, therefore, provides a gauge of each company’s own estimation of the extent to which it is paying less in taxes than what would be assessed if its tax positions were fully examined.<sup>35</sup> A 2010 study of disclosed tax reserve information, for instance, showed that the 500 largest U.S. public companies estimated that they had claimed, in total, over \$200 billion of tax benefits by taking tax positions that likely would not survive full scrutiny.<sup>36</sup>

### III. DIFFERENCES IN BURDEN ON THE IRS

As described above in Part II, the IRS faces significant resource constraints. As this Part III will describe, different taxpayers demand widely

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<sup>32</sup> For further discussion of FIN 48, see, for example, Carolyn Marie Suhocki, *A Little Ray of Sunshine: The Wells Fargo Case Predicts a Brighter Future for Protecting FIN 48 Workpapers*, 9 CHARLESTON L. REV. 447, 456–59 (2015); Ventry, *supra* note 8, at 478–79; Bret Wells, *New Schedule UTP: Uncertain Tax Positions in the Age of Transparency*, 63 BAYLOR L. REV. 392, 400–05 (2011).

<sup>33</sup> *Summary of Interpretation No. 48*, FIN. ACCT. STANDARDS BOARD (2006), <https://www.fasb.org/summary/finsum48.shtml> [<https://perma.cc/4JKD-MV3L>]. See also Wells, *supra* note 32, at 400–02.

<sup>34</sup> See Wells, *supra* note 32, at 400–02.

<sup>35</sup> See Wells, *supra* note 32, at 404.

<sup>36</sup> See Wells, *supra* note 32, at 404. See also Israel Klein, *Contemptuous Tax Reporting*, 2019 WIS. L. REV. 1161, 1166 (2019) (“When filing corporate tax returns, managers take advantage of the tax system’s underlying collection infrastructure, that is, the reliance on taxpayers to self-assess and self-report taxes due, and knowingly file tax returns that contain legal positions that correspond frivolously or not at all to the tax code and prevailing tax doctrines (‘contemptuous tax reporting’). . . . Contemptuous reporting involves managers reporting the tax results of a deal, or any other business transaction, by implementing in the report a tax interpretation of the code which they know to be inconsistent with prevailing tax doctrines, but has nevertheless not yet been positively ruled against.”); *id.* at 1190 (“Data about companies included in the S&P 500 index reveals that as of the end of the 2016 financial year (reported in fiscal year 2017), S&P 500 companies alone had more than \$192 billion worth of contemptuous positions. That is \$192 billion that S&P 500 companies themselves disclose as uncollected tax dollars due to contemptuous reporting.”).



varying amounts of the resources that the IRS has. A number of factors contribute to this variation, including: (1) the type of income earned by the taxpayer; (2) the type of deductions claimed by the taxpayer; and (3) the complexity of the taxpayer's transactions. Each of these factors is discussed, in turn, below.

### A. *Different Types of Income*

The type of each taxpayer's income contributes to the varying burdens imposed upon the IRS by different taxpayers because auditing a taxpayer is more costly when the taxpayer's income is not subject to third-party reporting. Some types of income are subject to information reporting and withholding.<sup>37</sup> For instance, if an employer pays a salary to an employee, the employer must withhold and pay to the IRS a portion of the payment, to be applied against the employee's ultimate tax liability, and the employer must provide a W-2 Form to the employee and to the IRS that reports the employee's salary, the tax withheld, and other information.<sup>38</sup> Many other types of income are also subject to information reporting (though not withholding). For instance, if a U.S. individual earns interest income on a bank account, the income is generally not subject to withholding, but the bank will provide the individual and the IRS a Form 1099 reporting the amount of interest income.<sup>39</sup> Some income is subject to neither withholding nor information reporting. For instance, a sole proprietor who runs his or her own bookstore earns income from selling books to customers for cash that is subject to neither information reporting nor withholding. The lack of third-party reporting makes auditing such a taxpayer more costly because it is more difficult for the IRS to detect underreporting of income that is not subject to third-party reporting.<sup>40</sup>

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<sup>37</sup> See *infra* note 38.

<sup>38</sup> *Form W-2: Wage and Tax Statement, I.R.S. (2020)*, INTERNAL REVENUE SERV., <https://www.irs.gov/pub/irs-pdf/fw2.pdf> [perma.cc/87Q4-YPS6]. For additional discussion of third-party information reporting and withholding requirements, see, for example, Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 697 (2007) ("As is well known, in a variety of situations, the federal government requires third parties to report to the government, with a copy to the taxpayer, amounts the payor transferred to the taxpayer. . . . Moreover, in some situations, the payor, such as an employer, must also withhold taxes from the payment and remit those taxes to the government.").

<sup>39</sup> *Form 1099-INT: Interest Income, I.R.S. (2021)*, INTERNAL REVENUE SERV., <https://www.irs.gov/pub/irs-pdf/f1099int.pdf> [perma.cc/TUC7-P8C7].

<sup>40</sup> For related discussion, see JOHNSON ET AL. *supra* note 5, at 17 ("In the case of simple returns where information can be easily reconciled with the information returns filed by third parties and there are no other indications of significant compliance issues, taxpayers are not audited and not contacted. Returns that have only a small number of simple issues identified in classification are routed to correspondence exams. More complicated returns are assigned to one of two types of audits that generally involve face-to-face interaction with the taxpayer: either an office audit handled by a Tax Compliance Officer at an IRS office or a field audit handled by a Revenue Agent, who may visit the taxpayer's place of business."). For discussion of how underreporting is more common with respect to types of income that are not subject to

Because income subject to third-party reporting can be easily verified by the IRS, one would expect that taxpayers would be less likely to underreport such income. Available statistics confirm this expectation.<sup>41</sup> The most recent IRS tax gap study estimates that, on average, 55% of income that should have been reported was not reported in cases in which the income is subject to little or no information reporting (like the bookstore example), compared to only 1% in cases in which the income is subject to substantial information reporting and withholding (wage and salary income).<sup>42</sup> Available data also suggests that the cost of auditing taxpayers who earn income that is not subject to third-party reporting—relative to the potential pay-off of discovering unreported income—may cause the IRS to audit fewer of those taxpayers.<sup>43</sup>

In some cases, the tax return itself will provide clues about the extent to which the type of income earned by a taxpayer will make the return more or less difficult to audit. Consider, for instance, an individual taxpayer (“Employee”) who reports entirely income from a salary that was subject to third-party reporting and withholding, and contrast Employee with another indi-

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third-party reporting (given the greater difficulty of detecting underreporting with respect to such income), see *infra* note 41.

<sup>41</sup> See *infra* note 42 and accompanying text. See also William A. Drennan, *Strict Liabilities and Tax Penalties*, 62 OKLA. L. REV. 1, 22 (2009) (“Noncompliance is rampant among individuals operating a business, particularly those receiving cash payments.”); Sagit Leviner, *A New Era of Tax Enforcement: From ‘Big Stick’ to Responsive Regulation*, 42 U. MICH. J.L. REFORM 381, 400–01 (2009) (“[T]ax enforcement findings generally support the conclusion that taxpayers are highly responsive to perceived or actual risk of detection in their compliance decisions. According to IRS estimates, compliance is most likely where the risk of detection is significant, such as where third-party reporting or withholding exists. . . . In contrast, non-farm sole proprietor income, which is subject to little third-party reporting or withholding, has a significantly higher rate of misreporting . . . .”); Leandra Lederman & Joseph C. Dugan, *Information Matters in Tax Enforcement*, 2020 BYU L. REV. (forthcoming 2020) (describing IRS estimates of voluntary compliance across different types of income); Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 U. KAN. L. REV. 971, 975–76 (2003) (“[I]t may not be surprising that ‘voluntary’ compliance rates are much higher for the types of income subject to information reporting (many of which also are subject to withholding) than for those that are not.”); Lederman, *supra* note 38, at 698 (“Amounts subject to withholding (e.g., wages and salaries) have a net misreporting percentage of only 1.2 percent. Amounts subject to third party information reporting, but not to withholding (e.g., interest and dividend income) have a slightly higher net misreporting percentage of 4.5 percent. Amounts subject to partial third-party reporting (e.g., capital gains) have a still higher net misreporting percentage of 8.6 percent. Amounts not subject to withholding or other information reporting (e.g., Schedule C income or other income) are the least visible, with a much higher net misreporting percentage of 53.9 percent.”); Morse, Karlinsky & Bankman, *supra* note 28, at 39 (“By far the most important determinant of tax compliance is income source. Taxpayers report cash income less accurately than income subject to third party reporting and/or withholding.”); Slemrod et al., *supra* note 28, at 1; Slemrod, *supra* note 28, at 29, 37; Ventry, *supra* note 8, at 434–35 (comparing compliance rates across different types of income).

<sup>42</sup> See JOHNSON ET AL., *supra* note 5, at 13–14.

<sup>43</sup> See Leigh Osofsky, *Concentrated Enforcement*, 16 FLA. TAX REV. 325, 364 (2014) (“For instance, the GAO reported in 2007 that the IRS’s enforcement programs annually contact less than five percent of estimated noncompliant sole proprietors. A principal explanation for this statistic is that finding cash business evasion requires intensive and expensive audits, which the limited enforcement resources cannot yield in sufficient quantities.”).

vidual (“Business Owner”) who reports a substantial amount of income from selling merchandise at a store that Business Owner owns and operates. Assuming there are no other relevant facts about these taxpayers, fully examining the tax outcome claimed by Employee will be significantly easier than fully examining the tax outcome claimed by Business Owner.

However, relevant differences between taxpayers that affect the difficulty of audit will not always be evident from the face of the return. Consider an individual taxpayer (“Tax Dodger”) who reports only income from a salary that was subject to third-party reporting and withholding. Imagine that Tax Dodger also earns income from a side business in which Tax Dodger sells merchandise for cash, but, unlike Business Owner, Tax Dodger neglects to report any of the resulting income. Although it will not appear so from the face of the return, Tax Dodger is more difficult to effectively audit than Employee because Tax Dodger has earned additional income that will be difficult to discover.

### B. Different Deductions

The examples above demonstrate ways in which the type of income a taxpayer earns can affect the difficulty of audit. It is also the case that the types of deductions a taxpayer claims can make the IRS’s task more or less difficult. If an individual taxpayer claims the standard deduction, rather than itemizing deductions, for instance, the IRS’s load is lightened. An individual taxpayer can choose between claiming the standard deduction or itemizing deductions.<sup>44</sup> If an individual claims the standard deduction, when calculating his or her taxable income, that individual will subtract the relevant standard deduction amount from the individual’s adjusted gross income (AGI).<sup>45</sup> Across taxpayers, the amount of the standard deduction generally does not vary subject to a few exceptions.<sup>46</sup> If a taxpayer elects to itemize deductions, in lieu of claiming the standard deduction, that taxpayer will subtract from AGI the dollar amount of certain expenses actually incurred by the taxpayer, subject to certain limitations.<sup>47</sup>

Because the amount of the standard deduction does not vary across taxpayers (subject to a few exceptions), it is fairly easy to verify that a taxpayer

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<sup>44</sup> I.R.C. § 63 (2018).

<sup>45</sup> AGI is calculated by subtracting from a taxpayer’s gross income various expenses, including certain trade or business expenses.

<sup>46</sup> See I.R.C. § 63(c). Regarding the exceptions, the standard deduction does vary based on the taxpayer’s filing status (married taxpayers filing a joint return, for instance, claim a different standard deduction amount than single taxpayers). See *id.* Second, a larger standard deduction is available for taxpayers who are at least 65 years old. See *id.* Third, a larger standard deduction is available for taxpayers who are blind. See *id.* A final source of variation results from the fact that some taxpayers are not eligible to claim the standard deduction. For instance, if a married couple opts to file separate returns and one of them itemizes deductions, neither can claim the standard deduction. See I.R.C. § 63(c)(6).

<sup>47</sup> See I.R.C. § 63(b), (d)–(e).

has claimed the proper amount.<sup>48</sup> Verifying that a taxpayer claimed the proper amount in itemized deductions, by contrast, is more difficult because the proper amount depends on, among other factors, the amount of actual expenses incurred by the particular taxpayer.<sup>49</sup>

Within the universe of itemized deductions, not all are equally difficult to verify because some will correspond to expenses subject to third-party reporting. Consider, for instance, the home mortgage interest deduction. In the case of debt incurred after December 15, 2017,<sup>50</sup> a taxpayer who itemizes deductions is allowed a deduction for interest incurred on acquisition indebtedness of up to \$750,000.<sup>51</sup> In most cases, the lender will provide a Form 1098 to the taxpayer and the IRS. Form 1098 contains information about the interest received by the lender from the taxpayer, the outstanding balance on the loan, the address of the property that secures the loan, and certain other information.<sup>52</sup> The information contained on Form 1098 does not allow the IRS to verify all of the facts relevant to the determination of whether the taxpayer claimed the home mortgage interest deduction in an appropriate amount.<sup>53</sup> However, the third-party reporting makes the task of verifying this deduction easier than verifying the deduction of an expense that is not subject to third-party reporting.

Independent of the decision to claim the standard deduction or itemize deductions, some taxpayers will be more difficult to audit as a result of other deductions that they claim. For instance, an individual might claim a deduction for trade or business expenses which are not itemized deductions and can be claimed regardless of whether the taxpayer claims the standard deduction or itemizes deductions.<sup>54</sup> Trade or business expenses are not generally subject to third-party reporting, and, thus, deducting such expenses makes a taxpayer more difficult to audit.<sup>55</sup>

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<sup>48</sup> For further discussion of the exceptions, see *supra* note 46.

<sup>49</sup> For instance, the deduction for home mortgage interest depends on the amount of interest paid by a taxpayer and other factors. I.R.C. § 163(h)(3) (2018 and Supp. I 2019). The deduction for medical expenses depends on the amount of uninsured medical expenses incurred by the taxpayer and other factors. *Id.* § 213. The deduction for state and local taxes depends on the amount of state and local tax liability incurred by the taxpayer and other factors. I.R.C. § 164 (2018). The charitable contribution deduction depends on the amount a taxpayer donates and other factors. *Id.* § 170.

<sup>50</sup> For debt incurred prior to that date, the rules are more generous. See *id.* § 163(h)(3)(F).

<sup>51</sup> See *id.* Acquisition indebtedness is debt incurred to acquire, construct, or substantially improve a qualified residence that is secured by the residence. See *id.* § 163(h)(3)(B)(i).

<sup>52</sup> INTERNAL REVENUE SERV., FORM 1098, MORTGAGE INTEREST STATEMENT (2021), <https://www.irs.gov/pub/irs-pdf/f1098.pdf> [<https://perma.cc/QV43-BYBD>].

<sup>53</sup> For instance, it does not allow the IRS to verify whether the taxpayer used the proceeds to acquire, construct, or substantially improve a qualified residence, as required by the Code. See I.R.C. § 163(h)(3)(B)(i).

<sup>54</sup> This is true of trade or business expenses other than unreimbursed employee trade or business expenses. See I.R.C. § 62(a)(1), (a)(2)(A).

<sup>55</sup> Somewhat relatedly, starting in 2011, firms that processed credit card payments reported payments received by businesses to the IRS. As a result, the IRS had access to third-party reporting of income received from non-cash sales, but many of the expenses of these businesses were not subject to third-party reporting. See Slemrod et al., *supra* note 28, at 2. A

As shown by the example involving Tax Dodger above, in the case of *income*, there is a very real possibility that something that makes the taxpayer more difficult to audit will not be determinable from the face of the tax return.<sup>56</sup> This possibility arises because the taxpayer might omit entirely income that is not subject to third-party reporting. In the case of *deductions*, by contrast, taxpayers would typically report too little tax liability as a result of over-claiming deductions (rather than underclaiming them).<sup>57</sup> Thus, for deductions unlike income, the taxpayer's return itself will provide a more reliable indication of whether the taxpayer's deductions will be difficult to audit.<sup>58</sup> The tax return itself will reveal the types of deductions the taxpayer claimed, and, unlike in the case of income, there is a low likelihood of unreported deductions that could make the IRS's task more difficult.

### C. Differences in Complexity of Transactions

Like the types of income earned and the types of deductions claimed, the complexity of the taxpayer's transactions can affect the difficulty of auditing that taxpayer. Any taxpayer—whether an individual or an entity—that engages in complex transactions demands a substantial amount of resources

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study was conducted to test the prediction that the response of some businesses to the new reporting requirements would be to substitute overstating deductible expenses (not subject to third-party reporting) for understating income (that was, in the case of credit card sales, now subject to third-party reporting). See Slemrod et al., *supra* note 28, at 2. The results of the study generally confirmed this prediction. See Slemrod et al., *supra* note 28, at 2.

<sup>56</sup> Along similar lines, the Supreme Court has reasoned that the particular difficulty of detecting unreported income is what justifies an extended statute of limitations for examining tax returns in some cases. See *Colony, Inc. v. Commissioner*, 357 U.S. 28, 36 (1958) (“We think . . . Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer’s omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage. And this would seem to be so whether the error be one affecting ‘gross income’ or one, such as overstated deductions, affecting other parts of the return.”).

<sup>57</sup> The latter, however, is not impossible. See, e.g., James Edward Maule, *No Thanks, Uncle Sam, You Can Keep Your Tax Break*, 31 SETON HALL LEGIS. J. 81, 85 (2006) (“Sometimes, however, a tax deduction or credit can cause a taxpayer’s tax liability to increase. Though seemingly counter-intuitive, the complex relationship among various federal income tax provisions may have that effect. For example, in some instances, decreases in adjusted gross income or taxable income reduce a credit and thus create an incentive to forego a deduction because the salvaged credit exceeds the tax savings generated by the deduction.”); *id.* at 86 (“Under certain circumstances, an itemized deduction can cause a taxpayer’s alternative minimum tax (‘AMT’) to increase by an amount greater than the reduction in regular tax generated by the deduction.”); *id.* at 87–89 (providing additional examples).

<sup>58</sup> Of course, not everything will be evident from the return. If two taxpayers claim an itemized deduction for medical expenses, for instance, one might involve the expense of straightforward medical care while the other might be payment for something for which the classification as medical care is more questionable. This difference will not, necessarily, be obvious from the face of the return.

if their claimed tax outcomes are fully examined.<sup>59</sup> The number of and complexity of transactions in which a taxpayer engages will generally not be fully revealed by the face of the taxpayer's return and accompanying schedules. The taxpayer's return will not provide this information partially because many items are reported on an aggregate basis, rather than transaction by transaction.<sup>60</sup> In addition, even when transactions are disclosed separately on a schedule, the information reported on any given return is often insufficient for purposes of distinguishing mundane transactions from ones that raise thorny tax issues.<sup>61</sup>

Despite the limited information regarding complex transactions that can be gleaned from the face of the tax return, some features of a tax return will offer a rough guide as to the onerousness of the IRS's task. In the case of a large company, Schedule UTP could provide an imperfect approximation. As a result of guidance issued by the IRS, certain large companies must file Schedule UTP, which contains information about their "uncertain tax positions."<sup>62</sup> "Uncertain tax positions" include, among other items, all tax posi-

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<sup>59</sup> See Blank, *supra* note 24, at 1640 ("In addition, some taxpayers, especially corporations and partnerships, file tax returns that are simply enormous. General Electric Corp.'s 2006 annual tax return and accompanying schedules, for instance, were the equivalent of over 24,000 pages.").

<sup>60</sup> See Ventry, *supra* note 8, at 458.

<sup>61</sup> See Blank, *supra* note 24, at 1640 ("In the example of Blue Chip Co.'s contingent liability tax shelter, all that would have appeared to the naked eye of an IRS agent reviewing Blue Chip Co.'s tax return would be a \$50 million tax-deductible loss on Schedule D of IRS Form 1120, along with many other capital gains and losses resulting from Blue Chip Co.'s sales of stock, bonds, and real estate during the year."); Ronald A. Pearlman, *Demystifying Disclosure: First Steps*, 55 TAX L. REV. 289, 294-97 (2002) ("In spite of . . . the fact that tax returns do include questions and mandated schedules intended to amplify the line-item entries on the returns, the current level of return disclosure . . . does not enable revenue agents to identify certain tax shelters. . . . To obtain an accurate picture of a tax shelter audit, it is necessary to appreciate the inordinate complexity of the income tax return of a large multinational business, in particular, the extraordinary volume of transactions underlying the numerical entries on the return. . . . Many tax shelter transactions are exceedingly complex. The tax effects may be buried within a large dollar entry on a particular line of the tax return or they may be reflected in several entries. Some transactions are comprised of subtransactions, each of which must be reviewed in order to understand the whole. Some involve foreign entities that do not file U.S. tax returns. Some may look quite innocent unless the tax effects are considered on a multiyear basis. In the audit of a complex business tax return, unless the revenue agent has very precise information about potentially questionable transactions, he will miss some of them no matter how smart he is, no matter what level of training he has, and no matter what statutory authority he possesses to obtain information from the taxpayer."); Ventry, *supra* note 8, at 458 ("IRS enforcement is so severely handicapped by informational asymmetries that taxpayers can engage in abusive tax planning, accurately report transactions associated with that planning, yet still provide the IRS no indication of abusive activity."); Ventry, *supra* note 8, at 458-59 (describing an example in which uncovering the facts of a tax shelter would require examining the returns of four different parties and stating, "In these transactions, paying more money to private sector attorneys and expert academics or recruiting law students with higher grades or more elite degrees will not uncover the tax shelter activity. In either case, the IRS misses the abusive behavior because there is no indication that anything is wrong.").

<sup>62</sup> For additional discussion of Schedule UTP, see, for example, J. Richard (Dick) Harvey, Jr., *Schedule UTP: An Insider's Summary of the Background, Key Concepts, and Major Issues*, 9 DEPAUL BUS. & COM. L.J. 349 (2011); Kathryn J. Kennedy, *The IRS's Recent Uncertain Tax Positions Initiative: A Tangle of Accounting, Tax and Privilege Issues*, 9 DEPAUL BUS. & COM.

tions for which the taxpayer reports a tax reserve on its financial statements as a result of certain accounting rules formalized by FIN 48.<sup>63</sup> The transactions reported on Schedule UTP will generally be transactions that yield tax consequences that the taxpayer estimates are not “more likely than not” to be upheld if fully vetted.<sup>64</sup> For each position reported on Schedule UTP, a taxpayer must “provide a concise description of the tax position, including a description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the issue.”<sup>65</sup> In the case of a taxpayer required to file Schedule UTP, the number of uncertain tax positions reported on the schedule provides an initial indication of the difficulty of auditing the taxpayer.<sup>66</sup> Such transactions will often involve a multitude of steps and a number of different entities, giving rise to factual complexity. In addition, the reason that the transaction’s tax treatment is uncertain may stem from the potential application of standard-based doctrines in tax law such as the substance over form doctrine, the step transaction doctrine, and various anti-abuse rules that are generally intended to prevent taxpayers from reaping the benefits of transactions designed to obtain more favorable tax consequences under a literal application of tax rules than what lawmakers intended.<sup>67</sup> Determining the proper application of these doctrines can be a difficult task.

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L.J. 401 (2011); Cheryl A. Kettler, *Mirror, Mirror On the Wall, What’s Transparency After All?*, 9 DEPAUL BUS. & COM. L.J. 321 (2011); Ilya A. Lipin, *Uncertain Tax Positions and the New Tax Policy of Disclosure Through The Schedule UTP*, 30 VA. TAX REV. 663 (2011); Suhocki, *supra* note 32, at 459, 463; Julia Ushakova, *Seeking Privileged Information Under Schedule UTP: Protections and Privileges for Taxpayers*, 9 DEPAUL BUS. & COM. L.J. 445 (2011); Wells, *supra* note 32, at 405–10.

<sup>63</sup> INTERNAL REVENUE SERV., INSTRUCTIONS FOR SCHEDULE UTP (FORM 1120) (2019), <https://www.irs.gov/pub/irs-pdf/i1120utp.pdf> [<https://perma.cc/L38K-MAXL>] (explaining that tax positions must be reported if either (1) the corporation or a related party has recorded a reserve with respect to that tax position for U.S. federal income tax in audited financial statements (*i.e.* it is a tax position for which a reserve is recorded as a result of FIN 48) or (2) no reserve was recorded for the reason that the corporation expects to litigate the position).

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> For the reasons discussed below, it is, however, only an imperfect proxy. *See infra* text accompanying note 118.

<sup>67</sup> Literature discussing these doctrines and rules is extensive. *See generally, e.g.*, Ellen P. Aprill, *Tax Shelters, Tax Law, and Morality: Codifying Judicial Doctrines*, 54 SMU L. REV. 9 (2001); Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5 (2000); Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 SMU L. REV. 131 (2001); Daniel Halperin, *Are Anti-Abuse Rules Appropriate?*, 48 TAX LAW. 807 (1995); James S. Halpern, *Putting the Cart Before the Horse: Determining Economic Substance Independent of the Language of the Code*, 30 VA. TAX REV. 327 (2010); David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 TAX LAW. 235 (1999); David P. Hariton, *When and How Should the Economic Substance Doctrine Be Applied?*, 60 TAX L. REV. 29 (2006); Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982); Jeffrey L. Kwall & Kristina Maynard, *Dethroning King Enterprises*, 58 TAX LAW. 1 (2004); Leandra Lederman, *W(h)ither Economic Substance?*, 95 IOWA L. REV. 389 (2010); Martin J. McMahon Jr., *Economic Substance, Purposive Activity, and Corporate Tax Shelters*, 94 TAX NOTES 1017 (2002); Joshua D. Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365 (1988);

## IV. THE TAX RETURN FILING FEE PROPOSAL

To address the IRS's limited resources and the varying difficulty of auditing different taxpayers, Congress should adopt a tax return filing fee.<sup>68</sup> As described in more detail in Part V, the fee's advantages include promoting fairness, raising revenue, and, to a lesser degree, promoting efficiency. Congress should design the fee so that it would vary based on certain taxpayer characteristics specified by Congress, with the general aim of collecting a higher fee from taxpayers who are more difficult to audit, subject to certain caveats discussed in more detail below.<sup>69</sup>

This Part IV will proceed by: first, discussing an analogy to the tax return filing fee that already exists in the tax context; second, discussing analogies outside of the tax context; third, explaining why the aims of the tax return filing fee are not already served by having a progressive tax system; and fourth, discussing how various considerations ought to determine the design of the tax return filing fee.

## A. A Tax Analogue: The Letter Ruling Request Fee

While a tax return filing fee might seem like an odd notion at first, precedents exist in the tax context and beyond. In the tax area, taxpayers are required to pay a fee to cover the costs of additional administrative burdens that they impose upon the IRS in some contexts.<sup>70</sup> For example, when a taxpayer plans to engage in a transaction with uncertain tax consequences, the taxpayer can seek a letter ruling from the IRS.<sup>71</sup> In order to seek a ruling, the taxpayer must submit a ruling request that describes all of the relevant

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David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312 (2001); Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX L. REV. 325 (2002); David A. Weisbach, *Disrupting the Market for Tax Planning*, 26 VA. TAX REV. 971 (2007); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215 (2002).

<sup>68</sup> For reasons described below, Congress would likely have to adopt this measure. See *infra* note 83 and accompanying text.

<sup>69</sup> This proposal could complement other measures—like a longer statute of limitations for auditing wealthier taxpayers. For discussion of these measures, see Joshua D. Blank & Ari D. Glogower, *Progressive Tax Procedure*, 96 N.Y.U. L. REV. (forthcoming 2021), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3653622](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3653622) [<https://perma.cc/BQ9D-MGRZ>].

<sup>70</sup> Prefiling agreements present another example of taxpayers paying a fee (and a fairly substantial fee at that) for imposing an additional burden on the IRS. In this context, a fee is paid in order to obtain a determination of applicable tax consequences after transactions are complete but before a tax return is filed. For a discussion of prefiling agreements, see, for example, Rachel Y. Holmes, *Forcing Cooperation: A Strategy for Improving Tax Compliance*, 79 U. CIN. L. REV. 1415, 1428–31 (2011).

<sup>71</sup> See Rev. Proc. 2020-1, 2020-1 I.R.B. 1, 8 (“A ‘letter ruling’ is a written determination issued to a taxpayer by an Associate office in response to the taxpayer’s written inquiry, filed prior to the filing of returns or reports that are required by the tax laws, about its status for tax purposes or the tax effects of its acts or transactions. A letter ruling interprets the tax laws and applies them to the taxpayer’s specific set of facts. A letter ruling is issued when appropriate in the interest of sound tax administration.”).



facts, the questions on which the taxpayer seeks a ruling, relevant legal authority, and how the authority applies to the taxpayer's facts.<sup>72</sup> In addition, the taxpayer must pay a user fee.<sup>73</sup> The fee charged varies somewhat based on the type of request,<sup>74</sup> and the fees are generally designed to cover the costs incurred by the IRS in considering and issuing the ruling.<sup>75</sup> Indeed, the statute requiring the imposition of a user fee provides that the fee shall be determined based on the average time and difficulty of responding to taxpayer requests.<sup>76</sup> For 2020, depending on the type of request and other factors, the fee could range from \$0 to \$30,000.<sup>77</sup> Discounted fees are charged in a variety of circumstances. For example, in 2020, a reduced fee of \$2,800 generally applies when the request comes from a taxpayer with a gross income of less than \$250,000, and a reduced fee of \$7,600 generally applies when the request comes from a taxpayer with a gross income of at least \$250,000 but less than \$1,000,000.<sup>78</sup>

At first glance, charging a fee for a letter ruling may seem entirely distinct from charging a tax return filing fee. Requesting a letter ruling entails going above and beyond what other taxpayers ask of the IRS. In addition, the taxpayer who receives a letter ruling obtains a benefit from doing so—the taxpayer to whom a ruling is issued generally can rely upon it if the taxpayer carries out the transaction consistent with the facts described in the ruling request.<sup>79</sup>

It is not clear, however, that the potential distinctions between a letter ruling fee and a tax return filing fee are sufficient to warrant imposing the former but not the latter. First, the observation that a taxpayer who requests a letter ruling imposes more of a burden on the IRS than the typical taxpayer does not meaningfully distinguish a taxpayer who seeks a letter ruling from a taxpayer who does not seek a letter ruling but still engages in a transaction with uncertain tax consequences. Any taxpayer who engages in a transaction with uncertain tax consequences imposes upon the IRS an administrative burden greater than the burden imposed by taxpayers who do not engage in such a transaction, regardless of whether the taxpayer seeks a letter ruling. The letter ruling requester imposes costs when seeking a ruling,<sup>80</sup> while the

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<sup>72</sup> *Id.* at 23–39 (setting forth general instructions for requesting letter rulings).

<sup>73</sup> *Id.* at 81–85 (listing the user fees for various types of letter ruling requests).

<sup>74</sup> *Id.*

<sup>75</sup> *See, e.g.*, Donald L. Korb, *The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21<sup>st</sup> Century: A View From Within*, 46 DUQ. L. REV. 323, 347 (2008) (“The fees are based on calculations of the actual cost to the Service of preparing the rulings . . . with discounted fees for lower income taxpayers.”).

<sup>76</sup> I.R.C. § 7528(b)(1)(B) (2018).

<sup>77</sup> Rev. Proc. 2020-1, 2020-1 I.R.B. 1, 81–85.

<sup>78</sup> *Id.* at 82.

<sup>79</sup> *See, e.g.*, Korb, *supra* note 75, at 348. This assumes that the taxpayer accurately and completely disclosed relevant facts when requesting the ruling. *See* Treas. Reg. § 601.201(1)(5) (1967).

<sup>80</sup> It is possible that the costs of issuing a letter ruling may be greater than the costs of auditing a transaction because redacted letter rulings are made public. Although they lack

taxpayer who engages in the same transaction but does not seek a ruling imposes costs when that taxpayer's transaction is audited.<sup>81</sup> It is true that a taxpayer who obtains a letter ruling from the IRS can go on to impose a burden on the IRS at the audit stage. However, at least with respect to the transaction that was the subject of the letter ruling, the IRS's task is simpler than it would have been had the taxpayer not obtained the ruling. As a former IRS commissioner observed, when a taxpayer obtains a letter ruling, "[T]he work of the auditing agents is also simplified. They need only verify that the facts of the consummated transactions correspond to the facts in the rulings."<sup>82</sup>

As mentioned above, there is a second potential distinction. The taxpayer who obtains a letter ruling receives a benefit (namely, certainty regarding the tax consequences of a contemplated transaction) that may justify levying a fee for seeking a letter ruling whereas filing a tax return does not provide the taxpayer with a benefit. This benefit distinction may be quite relevant in the sense that it affects who could enact the tax return filing fee—it is likely a step that Congress would have to take rather than the IRS on its own.<sup>83</sup> However, as a policy matter, the benefit distinction does not

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precedential value for other taxpayers per section 6110(k)(3) of the Code, the IRS may still need to take more care and time in deciding whether or not to issue a ruling than when making a decision on audit. Indeed, the IRS's hesitation to publish letter rulings was motivated by the concern that doing so would increase the risk to the IRS if a ruling reached an improper result. *See, e.g.*, Korb, *supra* note 75, at 346 ("Historically, the Service was very reluctant to release letter rulings publicly. . . . The letter ruling was developed to provide taxpayers with definite and reliable determinations as to the tax treatment of future transactions. This was achieved by creating a form of communication that was addressed to an individual taxpayer and concerned one particular transaction. By so doing, the Service limited the scope of the ruling and, accordingly, limited its risk. Responsibility for issuing rulings in such cases could be delegated to lesser officials."). The additional time and cost of a letter ruling is, however, mitigated by the fact that the taxpayer prepares a draft of the ruling and by the fact that other taxpayers cannot rely upon the ruling.

<sup>81</sup> As discussed below, the initial scope of the fee would be limited to taxpayers who file Schedule UTP and based upon the number of transactions reported on that schedule. To the extent that most transactions reported on Schedule UTP are audited, the transactions that would be subject to the tax return filing fee directly impose costs on the IRS at the audit stage. If a transaction reported on Schedule UTP is not audited, then it does not, directly, impose costs on the IRS at the audit stage. However, in such a case, the complexity of the transaction and the auditing burden that it would impose on the IRS might very well be part of the reason why the IRS lacks the resources to effectively audit the transaction. Thus, even if the transaction is not audited, it contributes to the IRS's administrative burden. Moreover, if the tax return filing fee were only imposed with respect to transactions that were audited, the IRS could, to some extent, control the amount of the fee by its decision to audit or not audit a given transaction, and, for reasons discussed below, the amount of the fee should be specified by a formula set by Congress and not variable based on discretionary decisions made by the IRS. *See infra* note 118.

<sup>82</sup> Korb, *supra* note 75, at 344.

<sup>83</sup> I.R.C. § 7528(a) provides that the IRS shall impose fees on "(1) requests to the Internal Revenue Service for ruling letters, opinion letters, and determination letters, and (2) other similar requests." I.R.C. § 7528(a) (2018). Thus, this existing statute is not broad enough to authorize a return filing fee because it refers to "requests," suggesting situations in which a taxpayer voluntarily asks something of the IRS. In addition, the lack of benefit to the taxpayer could be relevant in analyzing whether other statutory provisions could authorize the fee. *See,*

provide an entirely convincing rationale for treating taxpayers who engage in complex transactions with uncertain tax consequences differently depending on whether or not they seek a letter ruling. First, the fee for the letter ruling is generally designed with the aim of covering the costs incurred by the IRS,<sup>84</sup> and, as discussed above, those same costs are incurred by the IRS when it audits a taxpayer who did not seek a letter ruling. In addition to the fact that Congress requires that the IRS base the letter ruling request fee on the average time and difficulty of considering and issuing the ruling, various features of how the fee is designed suggest that it is, indeed, aimed at covering costs rather than correlating with the benefits received by the taxpayer. For example, consider the fact that the IRS assesses a discounted fee when certain related taxpayers request substantially identical letter rulings.<sup>85</sup> This discount is better explained by the costs to the IRS being lower than by the benefit to the taxpayers being lower. The cost explanation offers a better fit than the benefit explanation because issuing two identical rulings is less costly than issuing two non-identical rulings, but, by contrast, two different taxpayers obtaining identical rulings on which they can each rely obtain approximately the same benefit as two different taxpayers obtaining non-identical rulings on which they can each rely.<sup>86</sup>

Another sign that the letter ruling request fee is generally designed to cover the costs borne by the IRS rather than to require taxpayers to pay for a benefit they receive can be gleaned from the fact that, if the IRS decides to not issue a letter ruling (in which case the taxpayer receives very little benefit),<sup>87</sup> the taxpayer will not automatically receive a refund of the fee.<sup>88</sup> Rather, the taxpayer will only receive a refund in such a case if the IRS determines that a refund is “appropriate after taking into account all the facts and circumstances, *including the amount of the Service’s time and resources spent on the request.*”<sup>89</sup>

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*e.g.*, Clayton P. Gillette & Thomas D. Hopkins, *Federal User Fees: A Legal and Economic Analysis*, 67 B.U. L. REV. 795, 822–45 (1987) (describing the existing state of case law regarding fees that can be implemented by agencies and explaining how the authority to implement fees based on the Independent Offices Appropriation Act has generally been held to depend on whether or not the service provides specific benefits to the person(s) paying the fees and stating “courts have universally determined that regulation itself does not confer a benefit sufficient to subject members of the regulated industry to a fee.”).

<sup>84</sup> See *supra* notes 75–76 and accompanying text.

<sup>85</sup> Rev. Proc. 2020-1, 2020-1 I.R.B. 1, 82.

<sup>86</sup> The only reason that the identical nature of two rulings might make them slightly less than twice as beneficial as one ruling is that, even though the second taxpayer who receives the second ruling cannot technically rely on the first, the first still provides some beneficial indication of the IRS’s likely view of the transaction, so that the incremental benefit from the second ruling may be less than the benefit of the first ruling. However, given that the second taxpayer cannot, technically, rely on the first ruling, the second ruling still provides a significant benefit.

<sup>87</sup> The taxpayer still may receive some benefit by learning of the IRS’s refusal to issue the ruling prior to engaging in a transaction, which gives the taxpayer the opportunity to reconsider whether to execute the transaction at all.

<sup>88</sup> Rev. Proc. 2020-1, 2020-1 I.R.B. 1, 74.

<sup>89</sup> *Id.*

Second, a letter ruling request does not solely benefit the taxpayer who requests the ruling but can also provide various benefits to the IRS and other taxpayers. One benefit that a letter ruling request provides to the IRS is flagging an issue that the IRS might not otherwise consider by bringing to the IRS's attention a new type of transaction.<sup>90</sup> Regarding benefits to other taxpayers, even though taxpayers to whom a letter ruling was not issued cannot technically rely upon it,<sup>91</sup> the publication of issued letter rulings in anonymized form benefits taxpayers who consider engaging in similar transactions by providing them with a guide to the IRS's likely position on such transactions.<sup>92</sup> The fact that a letter ruling request provides benefits to parties other than the taxpayer who seeks the letter ruling and pays the request fee weakens the benefit justification for levying a fee on ruling requests but not on tax returns.

A third reason why the benefit distinction should not be used to justify a letter ruling fee and not a tax return filing fee is that charging a fee to a taxpayer who seeks a letter ruling but not to a taxpayer who engages in the same transaction without a ruling might skew taxpayer incentives towards not seeking a ruling—resulting in loss of the benefits of the letter ruling that would have accrued to the IRS and other taxpayers. By contrast, if Congress enacted a tax return filing fee and if a taxpayer who obtained a letter ruling (paying a ruling request fee) would generally not have to also pay the tax return filing fee with respect to that transaction,<sup>93</sup> then some taxpayers might be more inclined to seek letter rulings.

### B. *Non-Tax Fee Analogies*

Beyond the tax area, other analogies exist that also entail levying fees upon individuals and businesses to defray the costs that they impose upon regulators. For example, the Public Company Accounting Oversight Board (PCAOB), a federal regulatory entity tasked with overseeing the audit of

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<sup>90</sup> See, e.g., Korb, *supra* note 75, at 344 (“The rulings program is not a one-way street, however, and the Service similarly receives its share of the benefits: (1) letter rulings provide a high degree of uniformity in the application of the law and regulations because all rulings on prospective transactions, other than those concerned with qualification of exempt organizations and employee benefit plans, are issued by the Associate Chief Counsel Offices; (2) advance rulings tend to decrease the amount of litigation that the Service otherwise would be involved in; (3) the rulings program constitutes a source of valuable information to the Service by keeping it abreast of the kinds of transactions which are being consummated or considered by taxpayers; (4) the rulings program still serves as one basis for the published rulings program; and (5) the work of the auditing agents is also simplified. They need only verify that the facts of the consummated transactions correspond to the facts in the rulings.”).

<sup>91</sup> See Treas. Reg. § 601.201(1)(1) (1967) (“A taxpayer may not rely on an advance ruling issued to another taxpayer.”).

<sup>92</sup> See, e.g., Holmes, *supra* note 70, at 1427 (“All PLRs are then published in redacted form and often serve as helpful guidance for other taxpayers, although only the original taxpayer is entitled to rely on the ruling.”).

<sup>93</sup> See *infra* notes 158–159 and accompanying text for further discussion of why duplicate fees would not be paid.

financial statements of public companies, is funded largely by fees imposed upon those companies, with larger companies (based on market capitalization) paying higher fees.<sup>94</sup>

Patent application fees provide another analogy. The fee for a patent application varies based on numerous factors, some of which roughly correlate with how difficult it is for USPTO to process the application.<sup>95</sup> Numerous other examples can be found at the federal level, including fees collected from licensees by the Nuclear Regulatory Commission,<sup>96</sup> fees imposed by the Federal Communications Commission,<sup>97</sup> and fees imposed by the Federal Energy Regulatory Commission.<sup>98</sup> There are also numerous state and local examples.<sup>99</sup>

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<sup>94</sup> See, e.g., Gideon Mark, *Accounting Fraud: Pleading Scier of Auditors Under the PSLRA*, 39 CONN. L. REV. 1097, 1109–12 (2007). “The PCAOB’s annual budget, which increased to \$136.4 million for 2007, is primarily funded by publicly traded companies, open-end mutual funds, and other equity issuers, with fees based on average monthly U.S. equity market capitalization. In 2005, the PCAOB invoiced approximately 9600 issuers. The 1000 largest companies in the United States shoulder most of the burden, contributing about 84% of total fees in 2005.” *Id.* at 1111. One might argue that the fee analogies discussed here differ from a tax return filing fee because the person or entity paying these fees is engaging in activity that is not required and is receiving a benefit from doing so (the benefit of being considered for a patent, the benefit of being publicly traded, and so forth). By contrast, filing a tax return is required for most taxpayers. However, while filing a tax return is generally required, taxpayers are not required to make the decisions that lead to the imposition of the filing fee. For instance, at least initially, the fee would be imposed upon taxpayers who report tax positions on Schedule UTP. A tax position is reported on this schedule if, in the taxpayer’s estimation, the position does not meet the threshold of being “more likely than not” to be upheld if evaluated on the merits. See *supra* notes 62–66 and accompanying text. A taxpayer is not required to take a reporting position that is not more likely than not to be upheld—the taxpayer could, instead, take a less aggressive reporting position.

<sup>95</sup> U.S. PATENT AND TRADEMARK OFF., USPTO FEE SCHEDULE (2020) <https://www.uspto.gov/learning-and-resources/fees-and-payment/uspto-fee-schedule> [<https://perma.cc/S3FY-9E8K>].

<sup>96</sup> See, e.g., Gillette & Hopkins, *supra* note 83, at 842 (“Congress requires that the Nuclear Regulatory Commission . . . collect fees from licensees in an amount up to 33% of the costs incurred by the Commission.”).

<sup>97</sup> *Id.* at 842–43. (“COBRA amended the Communications Act of 1934 to prescribe charges for certain regulatory actions of the Federal Communications Commission . . . the Commission fees as passed are based primarily on the cost of providing particular services rather than on the value of the benefits conferred on regulatees.”).

<sup>98</sup> *Id.* at 844. (“Omnibus Budget Reconciliation Act of 1986 . . . requires the Federal Energy Regulatory Commission (‘FERC’) to ‘assess and collect fees and annual charges in any fiscal year in amounts equal to all of the costs incurred by the Commission in that fiscal year.’”). For additional examples, see, for example, *id.* at 840 (“[A] wide variety of other statutes authorize federal agencies to charge for services. . . . For instance, under the National Aeronautics and Space Administration Act of 1959, the National Aeronautics and Space Administration imposes fees based on a portion of total launch cost to companies that use space shuttles to launch privately owned satellites. In more mundane matters, the Land and Water Conservation Act of 1965 authorizes the Department of the Interior to impose daily fees for campsites and vehicle entrances to national parks. The Department of Justice also may charge individuals who seek to utilize Federal Bureau of Investigation fingerprinting services. Similar programs exact fees for government services rendered in reviewing patent design applications, providing grazing areas, and issuing passports.”).

<sup>99</sup> See, e.g., Ariel Jurow Kleiman, *Nonmarket Criminal Justice Fees*, 72 HASTINGS L.J. (forthcoming 2021) (manuscript at 11–17), <https://papers.ssrn.com/sol3/papers.cfm?abstract>

*C. Necessity for the Tax Return Filing Fee*

As the above examples demonstrate, imposing a tax return filing fee would not be entirely unparalleled. The proposal may, however, seem unnecessary at first. Critics might frame this objection as follows: if (1) higher income taxpayers already pay higher effective tax rates and (2) tax outcomes are, generally, more difficult to audit in the case of higher-earning taxpayers, then taxpayers that impose a greater burden already pay more in taxes, which, ultimately, fund the IRS. Thus, in a roundabout way, taxpayers that are more difficult to audit may already pay the equivalent of higher filing fees. However, that argument falls short.

It is true that, in general, higher-earning taxpayers may be more difficult to audit as a result of several factors including the fact that, compared to taxpayers with lower earnings, they are generally more likely to earn income that is not subject to third-party reporting;<sup>100</sup> they are generally more likely to claim itemized deductions;<sup>101</sup> they are generally more likely to claim item-

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<sup>100</sup> [\\_id=3528690 \[https://perma.cc/EQ9M-4DBG\]](https://perma.cc/EQ9M-4DBG) (describing increased use of fee financing by state and local governments in the criminal justice arena since the 1970s); Laurie Reynolds, *Taxes, Fees, Assessments, Dues and the "Get What You Pay For" Model of Local Government*, 56 FLA. L. REV. 373, 381 (2004) ("Local governments have a wide range of dues techniques at their disposal. These include: fees to use government-owned facilities, like a public transit system; assessments levied against property owners to pay for a locale-specific capital improvement, like sidewalks or street lights; regulatory fees designed to offset the negative impact of private sector activity, like a fee imposed on paint producers to counteract the effects of lead poisoning; or charges based on consumption of a government-provided service, like garbage collection or local utility service."); *id.* at 411 ("In many cases, the government will impose a regulatory fee in order to recoup the benefit the fee payer derives from governmental regulation, like when an owner pays a fee for participation in the development's permit approval process. In other cases, though, the fee is imposed not to recoup the value of a government granted benefit, but to offset the burden imposed by the activity subject to the fee."); Hugh D. Spitzer, *Taxes vs. Fees: A Curious Confusion*, 38 GONZ. L. REV. 335, 349–50 (2002) ("Inspection fees and processing fees are charges to people who ask the government to pay them special attention, or whose activities give rise to special regulatory oversight. In either case, governments must allocate resources to those projects or activities. Examples are building permit fees, septic or sewer installation charges, the portion of water connection fees used for an inspector to check a new hookup, housing registration and inspection fees, professional licensing fees, and driver's license examination fees that are used to process an individual's application and exam.")

<sup>100</sup> *See, e.g.*, William A. Drennan, *Strict Liabilities and Tax Penalties*, 62 OKLA. L. REV. 1, 8–9 (2009) ("For the vast majority of the working class and the poor, however, self-assessment is a myth. On the income side, wages are subject to withholding, which requires the employer to deduct the taxes and pay the IRS before the worker has a chance to file an annual income tax return. Also, interest, dividends, and proceeds from the sale of property are subject to information-reporting rules, which require the payer to send the IRS a Form 1099 stating the amount the taxpayer received before the taxpayer has a chance to file a tax return. If the worker or recipient fails to report part or all of the wages, interest, dividends or sale proceeds on the tax return, the government's computer-matching program will promptly send a bill for the tax deficiency. . . . Frequently the wealthy can influence whether the payer files an information return (Form 1099) and the amount reported.")

<sup>101</sup> *Id.* at 9 ("On the deduction side, the working class and the poor have little discretion in claiming deductions because of documentation requirements and the standard deduction. A taxpayer who claims the standard deduction cannot claim any itemized deductions, and over eighty-two percent of taxpayers with adjusted gross income below \$50,000 use the standard

ized deductions with respect to expenses that are not subject to third-party reporting;<sup>102</sup> and, presumably, they are more likely to engage in complex transactions.<sup>103</sup> A recent study in Scandinavia also suggests that the wealthy are more likely to engage in tax evasion, which can be very difficult to detect on audit.<sup>104</sup>

Yet, while taxpayers with higher earnings and more wealth likely are more difficult to audit, there are reasons to believe that, despite some progressivity in the tax system, they do not bear an additional tax burden that is commensurate with the additional auditing burden they impose. This is so because some of the very things that make taxpayers with more wealth and higher earnings more difficult to audit are the same things that *reduce* their effective tax rates. For example, a corporation that engages in a complex transaction that results in it claiming a tax benefit that might not be justified under a less aggressive interpretation of law, in one fell swoop, makes itself more difficult to audit and pays less towards covering the IRS's costs.<sup>105</sup> The same is true of a wealthy individual who uses his or her extensive resources to hide income more effectively than an individual of modest means.

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deduction. . . . On the deduction side, “over [ninety-three] percent of [taxpayers] with an [adjusted gross income] greater than \$200,000 itemized. . . . [S]tatistics indicate that itemizers engage in significantly more [tax] evasion than nonitemizers.”)

<sup>102</sup> *Id.* at 9–10 (“In addition, third-party reporting or stringent documentation requirements do not apply to many of the tax deductions claimed by the wealthy. As a result, wealthy taxpayers can truly self-assess, and in some cases choose not to pay the correct amount of tax.”).

<sup>103</sup> *Id.* at 11 (“The wealthy tend to engage in more complex economic transactions, which can involve uncertain tax results and again allow more discretion in filing. In contrast, the tax rules encountered by the working class and the poor tend to be simpler and difficult to avoid.”).

<sup>104</sup> Annette Alstadsæter, Niels Johannesen & Gabriel Zucman, *Tax Evasion and Inequality* (Nat'l Bureau of Econ. Research, Working Paper No. 23,772, 2017), <https://www.nber.org/papers/w23772.pdf> [<https://perma.cc/Z78R-BQ3B>] (“On average about 3% of personal taxes are evaded in Scandinavia, but this figure rises to close to 30% in the top 0.01% of the wealth distribution, a group that includes households with more than \$45 million in net wealth.”). See also Sarin & Summers, *supra* note 7, at 14 (“[H]igh net-worth individuals have more complex returns, and their income tends to accrue in opaque categories where information reporting, and thus compliance, is lowest. . . .”).

<sup>105</sup> Corporations often pay low effective tax rates. For example, a recent New York Times article reported that FedEx incurred no federal income tax liability in 2018. See Jim Tankersley, Peter Eavis & Ben Casselman, *How FedEx Cut Its Tax Bill to \$0*, N.Y. TIMES (Nov. 17, 2019), <https://www.nytimes.com/2019/11/17/business/how-fedex-cut-its-tax-bill-to-0.html> [<https://perma.cc/6NN4-AVDN>]. Another recent study found that about 400 of the largest corporations in the United States paid an average federal tax rate of about 11% on their profits in 2018. See Jeff Stein & Christopher Ingraham, *Corporations Paid 11.3 Percent Tax Rate Last Year, in Steep Drop Under Trump's Law*, WASH. POST (Dec. 16, 2019), <https://www.washingtonpost.com/business/2019/12/16/corporations-paid-percent-tax-rate-last-year-steep-drop-under-president-trumps-law/> [<https://perma.cc/2XHT-GUDC>].

*D. Design Considerations*

As discussed above, imposing a tax return filing fee is neither unparalleled nor unnecessary. When getting into the specifics, a number of objectives should dictate the precise design of the filing fee including: (1) charging higher fees for more difficult to audit taxpayers, (2) avoiding regressivity, (3) promoting administrability, (4) avoiding the exacerbation of underreporting by taxpayers, (5) guarding against taxpayers viewing the amount of the fee as indicative of the likelihood of audit, and (6) bolstering political feasibility. Each of these considerations, and how each would influence the design of the fee, are discussed below.

*1. Charging Higher Fees for More Difficult to Audit Taxpayers*

One of the principal reasons for a tax return filing fee is that more difficult to audit taxpayers impose a disproportionate burden on the IRS and therefore ought to pay for the higher costs, provided that they are able to bear these costs. As a result, the fee should, generally, be designed to increase with difficulty of audit. Because this goal must be balanced against other goals (such as avoiding regressivity, promoting administrability, and avoiding the exacerbation of underreporting), the amount of the fee would not perfectly correlate with the difficulty of audit. For instance, to avoid regressivity, no additional fee would be levied on taxpayers who claim certain difficult to audit deductions and credits that are disproportionately claimed by lower-income individuals, as discussed below in Part IV.D.2. As discussed below in Part IV.D.3, to make the fee more administrable, it would generally be tied to items already reported on a tax return. Given that already reported items are only an imperfect proxy for the cost of audit, linking the fee to already reported items sacrifices, to a degree, the goal of levying a higher fee on more difficult to audit taxpayers. As discussed below in Part IV.D.4, to avoid the exacerbation of underreporting, the fee would not be tied to the amount of any type of income reported by a taxpayer.<sup>106</sup> Given that some types of income are more difficult to verify than others, ignoring reported income forfeits an opportunity to more precisely link the amount of the fee to the onerousness of audit.

Despite these limitations, the fee could be designed to increase, generally, with costs of audit. As discussed below, initially, the fee ought to be limited to taxpayers who file Schedule UTP and based upon the number of uncertain tax positions reported on that schedule. To the extent that the number of positions reported on that schedule is a rough proxy for difficulty of audit, the fee would increase with difficulty of audit. If the fee were ex-

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<sup>106</sup> Instead of tying it to income, the fee, at least initially, would be based on the number of positions reported on Schedule UTP. If it were expanded beyond that category, it could be based on the amount of certain deductions and credits.



panded beyond this initial category, it could be tied to the amount of certain deductions and credits (other than those disproportionately claimed by lower income individuals) that are not verifiable by third-party reporting and that, as a result, impose a greater burden on the auditor.

## 2. *Avoiding Regressivity*

One potential drawback to instituting a fee for any type of government service is the possibility that the fee could disproportionately burden lower income individuals.<sup>107</sup> In other words, the fee could be regressive, representing a higher percentage of the income earned by individuals with lower incomes. Regressivity, however, is not inevitable—the structure of the tax return filing fee could and should avoid this result.<sup>108</sup>

In many respects, designing a tax return filing fee to increase with the difficulty of examining the tax outcome claimed by a taxpayer would be consistent with avoiding regressivity. These two goals are compatible because many of the features of a taxpayer and a taxpayer's return that increase the difficulty of audit tend to occur more frequently in the case of higher income taxpayers. For instance, as discussed above, compared to lower income taxpayers, higher income taxpayers are generally more likely to earn income that is not subject to third-party reporting,<sup>109</sup> claim itemized deductions,<sup>110</sup> claim itemized deductions with respect to expenses that are not subject to third-party reporting,<sup>111</sup> and engage in complex transactions with uncertain tax outcomes.<sup>112</sup> As a result of the greater difficulty of discovering unreported income earned by higher income taxpayers, a recent study estimates that, for individual taxpayers who earn more than \$10,000,000 per

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<sup>107</sup> See, e.g., Richard M. Bird & Thomas Tsiopoulos, *User Charges for Public Services: Potentials and Problems*, 45 CAN. TAX J. 25, 50 (1997) (“The most common objection to user charges is that they are ‘unfair’ and ‘regressive.’ In reality, however, appropriately designed user charges may be both fair and even progressive.”); David G. Duff, *Benefit Taxes and User Fees in Theory and Practice*, 54 U. TORONTO L.J. 391, 396 (2004) (“Critics, on the other hand, tend to object to benefit taxes and user fees on the grounds that they may impose a heavier burden on less affluent than on more affluent households. . . .”); Kleiman, *supra* note 99, at 37 (“Not only do the poor lack political power, but such targeting heightens the regressive effect of fee-funding.”).

<sup>108</sup> This is true of user fees, generally. See, e.g., Bird & Tsiopoulos, *supra* note 107, at 50 (“In reality, however, appropriately designed user charges may be both fair and even progressive.”); Gillette & Hopkins, *supra* note 83, at 817 (“Ordinarily, it should be quite possible to structure a user fee system in a way that satisfies concerns that a fee system is inherently regressive.”). In the case of the letter ruling request fee, for instance, the most recent revenue procedure provides for a reduced letter ruling request fee of \$2,800 if the request involves a personal, exempt organization, governmental entity, or business tax issue from a person with gross income of less than \$250,000. See Rev. Proc. 2020-1, 2020-1 I.R.B. 1, 81–85.

<sup>109</sup> See *supra* note 100 and accompanying text.

<sup>110</sup> See *supra* note 101 and accompanying text.

<sup>111</sup> See *supra* note 102 and accompanying text.

<sup>112</sup> See *supra* note 103 and accompanying text.

year, approximately 13.9% of their income is not reported, compared to 2.6% for individuals who earn less than \$200,000 per year.<sup>113</sup>

Furthermore, for other reasons discussed below, it would likely be advisable, at least initially, to institute a tax return filing fee that was fairly limited in scope—levied on taxpayers who file Schedule UTP. If the fee were expanded beyond that category and imposed upon individual taxpayers, regressivity concerns could be mitigated by generally not imposing any filing fee on individuals who claim the standard deduction and report only income subject to third-party reporting. Furthermore, no incremental filing fee should be charged for claiming certain deductions and credits if they are disproportionately claimed by lower income individuals<sup>114</sup>—such as, but not limited to, the Earned Income Tax Credit.<sup>115</sup>

### 3. Promoting Administrability

Another possible downside to instituting a tax return filing fee is that doing so could make even more difficult the IRS's already onerous job by requiring audit of yet one more item on some returns—the determination of the amount of the filing fee.<sup>116</sup> Linking the determination of the fee to items that a taxpayer already reports, however, can alleviate this concern to a significant degree.<sup>117</sup> For instance, if the fee were initially limited to taxpayers

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<sup>113</sup> See Sarin & Summers, *supra* note 7, at 6.

<sup>114</sup> In addition to avoiding regressivity, carving out such items is justified because much of the difficulty of audit is less within the control of the taxpayer compared to, for instance, transactions reported on Schedule UTP. For further discussion, see *infra* note 144.

<sup>115</sup> The Earned Income Tax Credit (the “EITC”) is a tax provision designed to provide economic relief to the working poor. A taxpayer’s eligibility for the EITC and the amount of any available EITC depend on a number of variables, and, as a result, the determination of a taxpayer’s eligibility and the calculation of the correct amount of the credit are not easy tasks. A full discussion of the EITC is beyond the scope of this Article. For further discussion of the EITC, see generally Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533 (1995); Leslie Book, *The IRS’s EITC Compliance Regime: Taxpayers Caught in the Net*, 81 OR. L. REV. 351 (2002); Leslie Book, *Preventing the Hybrid from Backfiring: Delivery of Benefits to the Working Poor Through the Tax System*, 2006 WIS. L. REV. 1103 (2006); Michelle Lyon Drumbl, *Those Who Know, Those Who Don’t, and Those Who Know Better: Balancing Complexity, Sophistication, and Accuracy on Tax Returns*, 11 PITT. TAX REV. 113 (2013); Francine J. Lipman, *The Working Poor Are Paying for Government Benefits: Fixing the Hole in the Anti-Poverty Purse*, 2003 WIS. L. REV. 461 (2003); Jonathan P. Schneller, *The Earned Income Tax Credit and the Administration of Tax Expenditures*, 90 N.C. L. REV. 719 (2012); Jonathan P. Schneller, Adam S. Chilton & Joshua L. Boehm, *The Earned Income Tax Credit, Low-Income Workers, and the Legal Aid Community*, 3 COLUM. J. TAX L. 176 (2012); Susannah C. Tahk, *The Tax War on Poverty*, 56 ARIZ. L. REV. 791, 797–803 (2014); David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 997–1012 (2004); Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867 (2005).

<sup>116</sup> For discussion of concerns regarding administrability of user fees, see, for example, Gillette & Hopkins, *supra* note 83, at 820 (“Consideration of how costly a user fee is to administer relative to the gross receipts expected from the fee is essential to any user fee being considered on revenue grounds.”).

<sup>117</sup> For this reason, linking the fee to items that are already reported may be preferable to, for instance, linking the fee to a taxpayer’s wealth, even if the latter approach might also well

who filed Schedule UTP, and a certain dollar fee was charged for each uncertain tax position already reported on Schedule UTP, the IRS would not have to audit anything additional. If the fee were expanded beyond that initial category of taxpayers, the amount of the fee imposed on a taxpayer could, for instance, be equivalent to a percentage of certain itemized deductions already reported on the tax return, certain deductions for trade or business expenses already reported on the tax return, and certain credits already claimed on the tax return.

Linking the fee to items that are already reported by a taxpayer sacrifices, to some degree, the goal of levying a fee that increases with difficulty of audit because items already reported by a taxpayer will only be a rough proxy for the difficulty of audit.<sup>118</sup> With respect to Schedule UTP, not every tax position reported is equally difficult to audit, and, as a result, the mere number of uncertain tax positions reported provides a very incomplete approximation of the difficulty of audit. In addition, transactions with fairly certain tax consequences (in the taxpayer's estimation) would not appear on Schedule UTP at all but could still contribute significantly to the difficulty of audit if they are complex. Furthermore, as discussed above, many actions that make a taxpayer difficult to audit (such as omitting income entirely from a return when it is not subject to third-party reporting) make no mark on the tax return at all.

The administrative costs that would accompany efforts to tie the fee more closely to the costs of potential audit, however, likely outweigh the benefits of increased precision. In addition, future improvements to the accuracy of the fee could go hand in hand with more refined disclosure requirements. From time to time, lawmakers impose upon taxpayers more detailed disclosure requirements as a means of enabling the IRS to examine returns

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serve many of the other goals of the filing fee, given that wealthier taxpayers are both more difficult to audit and more able to pay a filing fee.

<sup>118</sup> An alternative approach that could measure, more precisely, the cost of audit would be to base the fee on the amount of time the IRS actually spent auditing the taxpayer. That approach, however, would be problematic for a number of reasons. First, it would only impose a fee upon taxpayers who are audited. Second, allowing the IRS to, in effect, set the fee based on the amount of time spent auditing a taxpayer would give rise to the possibility that the IRS would inflate the amount of the fee (or, at least, create the appearance of having done so). For discussion of problematic incentives that arise in other contexts when an agency is able to determine the amount of the fee imposed upon persons that are required to use services provided by the agency, see Kleiman, *supra* note 99, at 23–24 (“[T]he consumption of criminal justice services is primarily decided by the government agency providing the service. This occurs because the administering agencies are monopolistic providers of mandatory services. These agencies, in turn, directly benefit from the collected fee revenue. They thus have both the power and incentive to pursue increased fee revenue at the expense of system users.”). For a related observation, see Raskolnikov, *supra* note 28, at 596 (discussing ways to determine the difficulty of detecting underreported income in the context of determining whether a higher penalty should be imposed under a regime that increases the penalty when the underreporting is more difficult to discover and stating, “[i]t would be hard to verify the government’s claims regarding the difficulty of identifying a given arrangement because no one but the government is engaged in tax audits and can serve to support or challenge the government’s assertions.”).

more effectively,<sup>119</sup> and scholars have proposed refining disclosure requirements even further.<sup>120</sup> As disclosure requirements evolve and become more detailed to make audits more effective, a collateral benefit is that more detailed disclosure requirements would present an opportunity to refine the tax return filing fee by tying it to return items that were more accurate proxies for the difficulty of audit. For example, some have suggested that Congress ought to consider requiring taxpayers to disclose and separately report the details of any asset disposition giving rise to a loss in excess of a specified dollar amount.<sup>121</sup> If such a proposal were implemented, a filing fee could be tied to each such transaction to defray the costs that the IRS would incur if it examined the claimed tax consequences. As an additional example of the possibility of expanding disclosure (and making corresponding increases to the scope of the return filing fee), lawmakers could enlarge the pool of taxpayers required to file Schedule UTP. For instance, the requirement to file Schedule UTP (along with an accompanying filing fee) could be imposed on any taxpayer holding assets in excess of a specified threshold amount.

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<sup>119</sup> See, e.g., Blank, *supra* note 24, at 1637–42; Ilya A. Lipin, *Failing Corporate Tax Transparency and the Immediate Need to Reduce Overburdening Duplicative Tax Reporting Requirements*, 27 AKRON TAX J. 119, 120 (2012) (“During the last decade, there has been a clear shift in the tax compliance mechanisms where the corporate taxpayer became responsible for divulging its financial, tax, and technical information to the Internal Revenue Service . . . .”); Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX. L. REV. 325, 352–54 (2002); Ventry, *supra* note 8, at 448–52; Wells, *supra* note 32, at 405–10.

<sup>120</sup> See, e.g., Loren D. Prescott, Jr., *Challenging the Adversarial Approach to Taxpayer Representation*, 30 LOY. L.A. L. REV. 693, 745 (1997) (“In order to provide the government with the information needed to test for taxpayer compliance and, when appropriate, to advance its own valid but debatable positions, the rules should require disclosure of return positions whenever any recognized authority exists that is contrary to the taxpayer’s position.”); Schler, *supra* note 119, at 371–72 (“Another possibility would be to require a detailed disclosure concerning the circumstances of any reported gross loss (capital or ordinary) exceeding some dollar amount arising on an asset disposition. The disclosure could include losses allocated to the taxpayer from pass-through entities. A statutory provision also could provide that in a tax shelter case, the loss would be disallowed in the absence of full and timely disclosure. Automatic disclosure also could be required for other items, such as (1) any substantial increase in a taxpayer’s tax basis for an asset not due to a direct cash investment, or (2) any redemption of a foreign or tax-exempt partner’s interest in a partnership for an amount substantially less than tax basis. . . . Congress could adopt a rule stating that a tax opinion would provide protection from penalties in a tax shelter transaction (or in any transaction) only if the taxpayer files the opinion with the original tax return.”). Another alternative would be to increase the level of confidence that taxpayers must have in their claimed tax consequences. See Wells, *supra* note 8, at 668 (“Given the systemic problems created by the tax gap and the public’s desire for greater voluntary tax compliance, this author proposes that existing law should be changed so that taxpayers, tax return preparers, and tax advisors could only endorse a tax position to be taken on a tax return without a risk of an understatement penalty or sanction, as the case may be, if the taxpayer, tax return preparer, or tax advisor, as the case may be, reasonably believed that the tax return position is likely to be sustained.”).

<sup>121</sup> Schler, *supra* note 119, at 371–72.

#### 4. *Avoiding the Exacerbation of Underreporting by Taxpayers*

One of the aims of a tax return filing fee is to raise revenue that could be used, at least in part, to fund the IRS's efforts to examine tax returns and collect additional revenue. If, however, a tax return filing fee goads taxpayers into underreporting their tax liabilities even more aggressively, then it will have missed its mark. Rather than provide additional fuel for IRS efforts, the filing fee would have made the IRS's job even more difficult.

There are two means by which a tax return filing fee could, counterproductively, exacerbate taxpayers' underreporting of tax liability, but the fee's design could be calibrated to mitigate these effects. First, a tax return filing fee might directly induce more extensive underreporting if it were levied on income (or types of income) so that it became an additional cost of reporting income (or particular types of income). Second, perceptions that a tax return filing fee is unfair might, indirectly, inspire less willingness to voluntarily comply with tax law.

The risk of the first possibility occurring is especially significant with respect to income that is not easy for the IRS to detect when it is not reported—in other words, income that is not subject to third-party information reporting or withholding. To avoid this effect,<sup>122</sup> the fee should not be based on the amount of any type of income reported by the taxpayer.<sup>123</sup>

Not linking the fee to the amount or type of income reported does sacrifice—to some degree—the goal of levying a higher fee upon taxpayers who are more difficult to audit. A taxpayer who reports income that is not subject to third-party reporting is more difficult to audit than a taxpayer who only earns (and only reports) income that is subject to third-party reporting. Thus, a precisely calibrated fee would be higher for the former taxpayer than for the latter. However, the risk that a tax return filing fee levied on income not subject to third-party reporting would induce more underreporting of such income likely outweighs the benefit of a more precisely calibrated fee. This is particularly true given that fifty-five percent of income not subject to third-party information reporting or withholding is already not reported,<sup>124</sup> and, as a result, the amount of such income reflected on a tax return is only a rough proxy for the difficulty of audit in any event. Thus, ignoring the amount of reported income when calculating the fee does not sacrifice much in terms of precisely calibrating the fee to difficulty of audit.

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<sup>122</sup> Not linking the fee to the type of income reported might also help to avoid regressivity to the extent that certain types of income that are difficult for the IRS to detect (like cash business income) are disproportionately earned by moderate income taxpayers.

<sup>123</sup> An alternative approach would be to levy a fee on income that is not verifiable by third-party reporting and impose the fee plus a penalty in cases in which the fee is underpaid as a result of the underreporting of income. However, given the low audit rate, the penalty may not be sufficient to offset the increased incentive to underreport created by the filing fee.

<sup>124</sup> See JOHNSON ET AL., *supra* note 42 and accompanying text.

As suggested above, at least initially, the fee might be limited to a charge imposed upon taxpayers who file Schedule UTP with the fee varying based on the number of uncertain tax positions reported on that schedule. If the fee were expanded and applied to individual taxpayers, it should not be based on the amount of any type of income reported. Instead, it could be based on the amount of certain types of deductions or credits claimed by the taxpayer, with generally higher fees for items that are not verifiable with third-party reporting. In addition, policymakers should take care to avoid levying a fee upon deductions and credits that are, disproportionately, claimed by lower income taxpayers.

With respect to a tax return filing fee levied upon tax positions reported on Schedule UTP, taxpayers have very strong incentives to ensure that Schedule UTP does not improperly omit any tax positions. As others have observed, the failure to file a complete Schedule UTP could expose the taxpayer to a number of unacceptable risks, including potential criminal penalties<sup>125</sup> as well as the possibility that the IRS would take a much more aggressive stance when requesting information from the taxpayer on audit.<sup>126</sup> These same incentives ought to limit the inclination of taxpayers to omit items from Schedule UTP in order to avoid the filing fee.<sup>127</sup>

With respect to a tax return filing fee levied upon deductions or credits, claiming deductions and credits typically lowers a taxpayer's tax liability.<sup>128</sup> As a result, the concern regarding a fee imposed on income—that it would induce underreporting of tax liability—does not arise, in parallel fashion, in the context of deductions or credits. Even with a filing fee, the taxpayer would continue to claim the deduction or credit if the resulting amount of tax saved is more than the filing fee. If the tax saved is less than the filing fee, the taxpayer might refrain from claiming the deduction or credit. However, doing so would typically result in increased tax liability rather than decreased tax liability (setting aside the fee). Thus, this change in reporting would not lead to a tax revenue loss (compared to a world without the fee) to

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<sup>125</sup> See, e.g., Wells, *supra* note 32, at 412–13 (“A second potential response is that a taxpayer would simply not complete final Schedule UTP. In this event, Section 7203 of the Internal Revenue Code theoretically could impose criminal penalties for failure to properly complete final Schedule UTP, but as has been pointed out by another commentator, it is often difficult for the IRS to prove ‘willful failure.’”).

<sup>126</sup> See Wells, *supra* note 32, at 413 (discussing how, in such a situation, the IRS might request all tax accrual workpapers from the taxpayer on audit).

<sup>127</sup> Basing the fee on the number of tax positions reported might, predictably, cause taxpayers to lump arguably separate tax positions together and treat them as one for purposes of reporting on Schedule UTP. However, the fact that a taxpayer had done this may be revealed as a result of the fact that the taxpayer must “[p]rovide a concise description of the tax position, including a description of the relevant facts affecting the tax treatment of the position and information that can reasonably be expected to apprise the IRS of the identity of the tax position and the nature of the issue.” INTERNAL REVENUE SERV., FORM 1120, INSTRUCTIONS FOR SCHEDULE UTP (2019), <https://www.irs.gov/pub/irs-pdf/i1120utp.pdf> [<https://perma.cc/L38K-MAXL>].

<sup>128</sup> In some cases, however, claiming a deduction could result in increased tax liability. See Maule, *supra* note 57.

the same degree as a change in reporting that entailed underreporting income.

As mentioned above, a tax return filing fee could also exacerbate underreporting if perceptions that a tax return filing fee was unfair inspired less willingness to voluntarily comply with tax law. Taxpayers might perceive unfairness in a system that requires them to pay a fee for something they did not want to do in the first place—file their tax returns.<sup>129</sup> Studies suggest that if an individual perceives that tax laws are implemented in a procedurally fair manner, the individual is more likely to report that noncompliance with tax laws is unacceptable.<sup>130</sup> Conversely, when certain individuals perceive procedural *unfairness* in the tax system, those individuals are more likely to indicate that they intend to not comply with tax law in the future.<sup>131</sup> Whether changes in attitudes towards tax compliance translate into actual changes in tax compliance, however, is an issue that these studies do not address definitively.<sup>132</sup>

The risk that the perceived unfairness of a tax return filing fee could affect tax compliance is one justification for limiting the fee to companies that must file a Schedule UTP, as a test case.<sup>133</sup> If the fee were expanded to individuals, its impact upon perceptions of fairness could be affected by how

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<sup>129</sup> This is a potential concern in connection with a fee for mandatory services generally. See, e.g., Gillette & Hopkins, *supra* note 83, at 818 (“The fairness of charging a user fee may be questionable if individuals are required by law to use a service.”). Furthermore, some have discussed the possibility of the IRS compensating taxpayers for burdens imposed upon taxpayers in order to improve perceptions of fairness or serve other goals. See, e.g., Joseph Bankman, *Tax Enforcement: Tax Shelters, The Cash Economy, and Compliance Costs*, 31 OHIO N.U. L. REV. 1, 9–10 (2005); Sarah B. Lawsky, *Fairly Random: On Compensating Audited Taxpayers*, 41 CONN. L. REV. 161, 208 (2008) (“Even though it is generally fair for the government not to compensate taxpayers for randomly imposed audit costs, taxpayers may still perceive this lack of compensation as unfair. This perceived unfairness should matter to a welfarist, because people prefer to comply with laws, including tax laws, that they perceive to be fair. In particular, if randomly imposing audit costs on a few individuals for the good of the whole is seen as unfair and thus creates demoralization costs, compensating taxpayers for these randomly imposed audit costs may reduce social costs and increase compliance.”). See also Emily A. Satterthwaite, *Rewarding Honest Taxpayers: An Experimental Assessment*, 22 FLA. TAX REV. 200, 220–28 (2018) (describing an experiment used to assess whether token rewards to taxpayers who were found to be compliant on audit could improve compliance).

<sup>130</sup> See, e.g., Kent W. Smith, *Reciprocity and Fairness: Positive Incentives for Tax Compliance*, in *WHY PEOPLE PAY TAXES* 223 (Joel Slemrod ed., 1992). For a summary of the studies, see Lederman, *supra* note 41, at 1000–02. See also Drennan, *supra* note 100, at 48 (“Norms that may decrease compliance include perceptions that the tax rules are unfair or that the IRS is a bully.”); Lawsky, *supra* note 129, at 182–84; Leviner, *supra* note 41, at 415–16 (“It is well understood today that the perceptions taxpayers have of the procedural justice of the tax system—how the tax administration treats them and other similarly situated taxpayers—affect the legitimacy these taxpayers attribute to the administration and the extent to which they accept its authority. This, in turn, impacts the taxpayers’ levels of compliance.”).

<sup>131</sup> Karyl A. Kinsey, *Deterrence and Alienation Effects of IRS Enforcement: An Analysis of Survey Data*, in *WHY PEOPLE PAY TAXES* 259 (Joel Slemrod ed., 1992).

<sup>132</sup> See, e.g., Lederman, *supra* note 41, at 1000–01; Leigh Osofsky, *Some Realism About Responsive Tax Administration*, 66 TAX L. REV. 121, 141 (2012).

<sup>133</sup> It is also theoretically possible that tax compliance by large companies may be less susceptible to being influenced by perceptions of fairness in the tax system.

the fee is described—rather than framing it as a fee paid for filing a tax return, it could be described as a payment made by taxpayers who engage in complex transactions so that they bear the higher burden imposed on the IRS by their activities. At least for some taxpayers, such a fee could have the potential to make the system seem more fair rather than less so.

### 5. *Guarding Against Reverse Engineering*

To the extent that a tax return filing fee correlates with the cost of auditing a taxpayer, taxpayers might interpret the amount of the fee as a signal of the likelihood of audit. As mentioned above, for instance, some evidence suggests that the IRS audits some taxpayers less frequently, in part, because of the high cost of audit.<sup>134</sup> Thus, taxpayers might “reverse engineer” the fee and assume that, if the fee is higher, the likelihood of audit is lower, and taxpayers might use this information to alter their reporting to try to decrease the likelihood of audit.

This risk, however, is not significant for two reasons. First, the probability of audit also depends on the likelihood of recovering additional tax revenue and other factors which would be unconnected to the amount of any filing fee.<sup>135</sup> Second, the amount of the filing fee would not correlate perfectly with the cost of audit but rather would represent only a rough proxy given that it is tied only to certain items reported on the return. As a result, the amount of the fee would be a very unreliable signal of the likelihood of audit.

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<sup>134</sup> See Osofsky, *supra* note 43, at 364.

<sup>135</sup> For discussion of the process of selecting returns for audit, see, e.g., Lawsky, *supra* note 129, at 164–68 (describing the ways in which the IRS selects individuals’ tax returns for audit and noting that the IRS selects some returns for audit based on a return’s “Discriminant Index Function,” or “DIF” score.”); Osofsky, *supra* note 43, at 335–36 (“While the IRS’s auditing strategies are shrouded in secrecy, various government authorities have indicated that the IRS uses the DIF score as a primary method to determine which taxpayers to audit. The DIF score employs a ‘worst-first’ approach by focusing on taxpayers who are likely to be the most noncompliant, as determined by deviation from others. The IRS has described that the DIF score rates tax returns based on their ‘potential for [tax] change, based on past IRS experience with similar returns.’ The General Accounting Office, now the Government Accountability Office (‘GAO’), has explained that DIF scores ‘are automatically calculated for all filed individual returns’ and that this ‘calculation is based on a series of formulas developed by the IRS that are designed to indicate the returns that have the highest probability of a tax change if audited.’ As implied from the above description, the DIF score focuses on the direct revenue yield from audit, allocating resources based on the tax liability that would be paid as a result of audit.”). As Professor Lawsky describes, “[t]he DIF appears to be an effective method for selecting returns to audit because it permits the IRS to focus its audits on returns that are more likely to yield additional tax revenue. In 1968, the DIF did not yet exist, and forty-three percent of audited returns resulted in no change. That is, forty-three percent of audited returns provided no additional tax revenue. In 1994, returns selected for audit based on DIF scores had only a nineteen percent no-change rate—that is, only nineteen percent of returns selected for audit using the DIF provided no additional tax revenue. . . .” Lawsky, *supra* note 129, at 165–66.



## 6. Bolstering Political Feasibility

Instituting a tax return filing fee would require Congressional action and is, admittedly, highly unlikely in the current political environment.<sup>136</sup> A Congress that drastically cut the IRS's budget in recent years is unlikely to enact a filing fee to fund the IRS.<sup>137</sup> That said, a Congress more favorably disposed to funding the IRS might consider such a measure. At times, efforts to close the tax gap have attracted numerous proponents, including in Congress.<sup>138</sup> The tax return filing fee could be framed in a similar vein as a means to help the IRS collect the taxes that people already owe in order to put off having to institute a tax hike across the board.<sup>139</sup> Framing the filing fee in this way would be more convincing to the extent that there is more overlap between taxpayers who are required to pay the filing fee and taxpayers who are paying less in taxes than they owe. To this end, keeping the filing fee narrow in scope by only applying it to transactions reported on Schedule UTP might be desirable. Not only is a transaction reported on Schedule UTP likely to impose a significant burden on the IRS (given the complexity of most such transactions) but it is also likely to contribute to the collection of less tax than what ought to be paid (given that the taxpayer estimates that the claimed tax consequences are not more likely than not to be upheld if subject to full scrutiny).

A tax return filing fee could also have some, incidental, ramifications for the political feasibility of other measures. If the fee were greater for taxpayers who claim deductions for expenses that are not subject to third-party reporting, for instance, proposals to expand third-party reporting might garner more enthusiasm, and more third-party reporting could prove to be quite valuable in some situations.<sup>140</sup> In at least one context, lobbying by affected parties has limited the use of third-party reporting.<sup>141</sup> Taxpayers might be less resistant to more extensive third-party reporting if those taxpayers who claimed items not subject to such reporting bore some of the resulting additional costs incurred by the IRS.

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<sup>136</sup> Regarding the requirement for congressional action, see *supra* note 83 and accompanying text. Also, there are other important reasons for Congress controlling the determination of the fee. See *supra* note 118.

<sup>137</sup> For discussion of these budget cuts, see *supra* Part II.

<sup>138</sup> See *supra* note 8 and accompanying text.

<sup>139</sup> Regarding the effect of the tax gap on compliant taxpayers, see, for example, Drennan, *supra* note 100, at 3 (“Taxpayers who fail to pay their fair share cause each honest taxpayer to pay on average over \$2000 extra in federal income taxes every year.”). Admittedly, because the proposal is limited so that the tax return filing fee would not be levied on items disproportionately claimed by lower income individuals, it might encounter greater resistance than some tax-gap-closing proposals.

<sup>140</sup> In some situations, third-party reporting will not be effective or efficient. For further discussion, see Lederman, *supra* note 28, at 1737, 1739–41.

<sup>141</sup> See, e.g., Lily Kahng, *Path Dependence in Tax Subsidies for Home Sales*, 65 ALA. L. REV. 187, 212, 224–27 (2013) (describing the influence of the real estate lobby in the context of the adoption of provision that eliminates the requirements for brokers to report homes sales in certain cases).

## 7. Summary

Congress should institute a tax return filing fee that increases with the difficulty of auditing each taxpayer. The amount of the fee would be linked to items that taxpayers must already report to promote administrability. The fee would not be connected to the amount or type of income reported to avoid the exacerbation of underreporting.

Initially, the fee could be levied only upon taxpayers who file Schedule UTP and based upon the number of uncertain tax positions reported on that schedule. The fee could potentially be expanded to taxpayers who claim certain deductions and credits that are not verifiable with third-party reporting, carving out items that are disproportionately claimed by lower income taxpayers.

In addition, future improvements to the accuracy of the fee could go hand in hand with more refined disclosure requirements. As disclosure requirements evolve to become more detailed for the independent reason of making audits more effective, the more detailed disclosure requirements would present an opportunity to refine the tax return filing fee by tying it to return items that are more closely correlated with the costs of audit.

## V. REASONS TO ADOPT A TAX RETURN FILING FEE

A tax return filing fee offers several advantages. The primary advantages—and the main reasons for its adoption—are fairness and increased revenue. In addition, while its overall effect on efficiency is unclear, it has the potential to create some beneficial incentives for taxpayers. Each of these advantages is discussed, in turn, below.

### A. Fairness

Some taxpayers demand more of the IRS than others because their claimed tax outcomes are more difficult to verify and examine. At least in cases in which taxpayers who require more of the system's resources are also more able to pay for the costs they impose, requiring that they do, in fact, pay for those costs is equitable.<sup>142</sup> As discussed above, with respect to the

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<sup>142</sup> A fairness rationale is also used to justify other user fees for government services. In these other contexts, the fairness rationale is generally articulated as justifying the imposition of a fee upon someone who receives more of a benefit from or uses a service more than others. Although taxpayers who engage in complex transactions do not directly benefit from IRS enforcement more than others, they do benefit from engaging in the transactions, and the transactions impose a greater burden on the IRS than activities of taxpayers with more readily determinable and apparent tax consequences. For discussion of the fairness rationale for other user fees, see, for example, Bird & Tsiopoulos, *supra* note 107, at 44 (“[I]f the demand for the service is virtually inelastic—then any price charges for the service will simply ‘tax’ those who use it. In these cases, user charges may nonetheless be justified on the ground of fairness. Why should the cost of providing a service, even a mandatory one, be paid for by someone

initially contemplated scope of the fee (a fee based on transactions reported on Schedule UTP), the fee would be levied even if the claimed tax position is ultimately determined to be correct.<sup>143</sup> While that might seem harsh, it is useful to bear in mind that the justification for the fee is to cause taxpayers to bear the costs of the additional burdens they impose on the IRS. If a

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other than the user?"); Duff, *supra* note 107, at 396 (describing that “benefit taxation embodies a basic principle of fairness, since taxpayers pay only for those publicly provided goods and services that they use.”); Gillette & Hopkins, *supra* note 83, at 814–15 (“[T]he fairness issue is whether, for any given program, a user fee is a suitable means to lessen burdens that otherwise would be borne by taxpayers who derive little or no benefit from the service. When direct beneficiaries of a government program pay no user fee, or one that falls short of the cost of the service they receive, a burden is shifted onto other segments of society (including taxpayers as a whole).”).

<sup>143</sup> Other scholars have proposed measures that would, in effect, cause certain taxpayers to pay more when they impose additional administrative burdens upon the IRS. In addition to differing in other respects, these proposals entail imposing a penalty upon taxpayers after the IRS engages in a successful audit that uncovers underreporting. By contrast, this Article’s proposal aims to impose a fee upon taxpayers in an amount that can be readily determined at the time the taxpayer files a tax return and that does not depend on the IRS successfully challenging a position claimed by the taxpayer. Regarding these other proposals, first, Professor Cords has proposed that any taxpayer taking the position that they are not subject to tax as a result of a tax protestor argument should be subject to an additional penalty. *See* Cords *supra* note 9, at 1519. As Professor Cords explains, tax protestors take the position that they are not subject to tax liability based upon frivolous positions that courts have repeatedly rejected including, for instance, various arguments that the government lacks the constitutional authority to collect taxes. *See* Cords *supra* note 9, at 1517–18, 1537–43. In order to force such taxpayers to pay for the costs they impose on the system, she proposes the imposition on a taxpayer who bases a tax position on a tax protestor argument of an automatic penalty equal to costs incurred by the IRS and courts in collecting the tax liability owed by the taxpayer. *See* Cords *supra* note 9, at 1567–68. Although driven by somewhat similar considerations—namely, requiring certain taxpayers to pay for the disproportionate burdens they impose—this Article’s proposal is aimed at a somewhat different problem—requiring, in particular, taxpayers who file Schedule UTP to pay for the additional administrative burdens that they impose. Also, the amount of the tax return filing fee would be determinable at the time the tax return was filed and its imposition would not depend on the IRS successfully auditing the taxpayer and challenging a position claimed by the taxpayer. A second, somewhat related, proposal was made by Professor Raskolnikov, and his proposal entails designing a penalty to discourage underreporting that would be higher for taxpayers whose underreporting was more difficult to detect. *See* Raskolnikov, *supra* note 28, at 572, 599–605. His proposal takes as a given that penalties for underreporting will only be imposed once a taxpayer is successfully audited, and he seeks to design a penalty so that its amount increases as the probability of detection declines. *See* Raskolnikov, *supra* note 28, at 572, 599–605. That way, taxpayers cannot reduce the expected value of the penalty that they face by taking steps to make their underreporting more difficult to discover (such as burying overstated deductions on the same line as legitimate deductions). *See* Raskolnikov, *supra* note 28, at 572, 599–605. Thus, he proposes higher penalties for more difficult to detect underreporting as a means of adjusting the expected penalty to deter underreporting. *See* Raskolnikov, *supra* note 28, at 572, 599–605. When underreporting is more difficult to detect, the burden on the IRS of detecting it will be greater, but, for purposes of Professor Raskolnikov’s proposal, the relevance of that greater burden is that it makes underreporting more difficult to detect. By contrast, this Article is concerned with the greater burden imposed by certain taxpayers for reasons of fairness. This Article seeks to require that taxpayers who impose an inordinate administrative burden on the IRS, and who have the ability to defray those costs, pay for the burden they impose. The initial scope of the proposal would entail levying a fee upon taxpayers based on the number of transactions reported on Schedule UTP. The fee would be assessed regardless of whether the IRS successfully challenged the claimed tax position because, even without a successful challenge, such taxpayers impose significant burdens on the tax administration system.

taxpayer engages in a complex transaction and claims tax consequences knowing that they are not “more likely than not” to be upheld if the transaction is fully vetted, the taxpayer has imposed significant costs on the tax administration system even if the taxpayer ultimately succeeds in having the claimed tax outcome upheld.<sup>144</sup> In a similar fashion, a taxpayer who requests a letter ruling from the IRS regarding the tax consequences of a planned transaction does not obtain a refund of the letter ruling request fee if the IRS agrees with the taxpayer’s proposed tax treatment of the transaction and issues the requested ruling.

In addition, a tax position reported on Schedule UTP is one that, in the taxpayer’s estimation, is not “more likely than not” to succeed on the merits. Despite this low likelihood of success, a sophisticated taxpayer with extensive resources might use those resources to obtain a favorable outcome in litigation or a favorable settlement that might not be justified given the aggressiveness of the claimed tax position. If obtaining a favorable outcome resulted in the taxpayer’s exemption from the filing fee, then the same resource imbalances between the IRS and the private tax bar that the fee could help address would have been wielded to undermine the fee. An exemption from the return filing fee in such cases would undercut the potential for the fee to supply the needed additional IRS resources.

### B. Revenue

In addition to creating a fairer system, a tax return filing fee would raise additional revenue, which is one of the justifications offered for government user fees more generally.<sup>145</sup> The tax return filing fee could raise revenue in two ways. First, it would raise revenue as a result of taxpayers paying the fee. Second, to the extent that the proceeds of the fee funded additional IRS enforcement activities, the fee could raise further revenue. A recent study, for instance, estimates that restoring the IRS’s budget to previous levels to allow for increasing the audit rate of taxpayers (particularly high earners)

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<sup>144</sup> Furthermore, especially in the context of transactions reported on Schedule UTP, the ability of lawmakers to eliminate or reduce uncertainty is limited by the actions taken by taxpayers themselves. Much uncertainty in tax law arises because lawmakers make use of various standard-based doctrines and anti-abuse rules as a backstop to the results that would be produced by a literal application of clear rules when taxpayers structure transactions to produce more favorable consequences than lawmakers intended when crafting the rules.

<sup>145</sup> See, e.g., Kleiman, *supra* note 99, at 47 (“If fees are deemed necessary—perhaps to raise essential revenue in the face of tax limits—they should be subject to principled constraints.”); Reynolds, *supra* note 99, at 392–93 (discussing how local governments have resorted to user fees to raise revenue as a way to address limitations on their ability to raise tax revenue). The amount of revenue raised would also depend on the costs of administering the fee. For discussion of this issue, see generally Gillette & Hopkins, *supra* note 83, at 820 (“Consideration of how costly a user fee is to administer relative to the gross receipts expected from the fee is essential to any user fee being considered on revenue grounds.”). As discussed above, the fee could be tied to items that must already be reported in order to lower administrative costs. See *supra* Part IV.D.3.

combined with other efforts to improve enforcement (such as enhanced third-party reporting and improved IRS technology) could raise approximately \$1.1 trillion of additional revenue over the 2020 to 2029 time period by narrowing the tax gap.<sup>146</sup>

The revenue raised by the tax return filing fee need not, necessarily, be earmarked entirely for IRS enforcement activities, thus obviating the need to calibrate the amount of the fee with the goal of any specific target for an enforcement budget in mind.<sup>147</sup> Oftentimes, government user fees are earmarked for use in funding the services for which they are charged.<sup>148</sup> As discussed in the literature on government user fees, the earmarking approach is frequently used when one of the goals of imposing a fee is to better gauge public demand for the service and allow that demand to dictate the amount of the service made available.<sup>149</sup> For instance, a fee charged for government-provided transportation that is earmarked to fund the transportation budget allows public demand for the service to determine how much of the service is offered. No such goal is served by a tax return filing fee, given that it is imposed on the mandatory activity of filing a tax return.<sup>150</sup> As a result, the typical rationale for earmarking does not apply in the case of a tax return

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<sup>146</sup> See Sarin & Summers, *supra* note 7, at 3.

<sup>147</sup> One of the criticisms of user fees is their potential to reduce budgetary flexibility. See, e.g., Duff, *supra* note 107, at 396 (“Critics, on the other hand, tend to object to benefit taxes and user fees on the grounds that . . . flexibility is limited where revenues are earmarked to expenditures on the publicly provided goods or services from which the revenues are derived.”). This concern does not arise, however, when the proceeds of the fee are not earmarked for any particular purpose.

<sup>148</sup> For discussion of the extent to which earmarking happens at the federal level, see Gillette & Hopkins, *supra* note 83, at 863 (“Currently, the disposition of user fees varies. Those user fees based on IOAA authority flow into the U.S. Treasury’s general fund, to be appropriated in the same way as are taxes and other revenues. Other user fees are earmarked for spending only on the activity generating them. This earmarking can take the form of a dedicated trust fund, aviation and highways, for example, a revolving fund, or a special fund, which differ in various ways, including the extent to which appropriations measures are involved in spending the funds.”).

<sup>149</sup> See, e.g., Bird & Tsiopoulos, *supra* note 107, at 47 (“Strict earmarking reverses the sequence of revenue and expenditure decisions: revenue collections drive subsequent expenditure levels. Taxpayers know that when certain tax (or user charge) payments are extracted from them the funds will be used to pay for certain kinds of services; if they want the services, then presumably they will support the charges.”); Duff, *supra* note 107, at 408 (“Where the revenues from benefit taxes and user fees are earmarked for expenditures on the goods and services from which they are derived, as they arguably should be, it is true that benefit taxation limits the flexibility of government budgetary decisions. This consequence, however, reflects nothing more than the enhanced accountability associated with this method of public finance. Indeed, one might well question the implicit assumption underlying many arguments for budgetary flexibility that politicians and policy makers are inevitably better placed to assess optimal expenditures in various areas than the taxpayers who bear the costs of these expenditures. Where this assumption is reversed, on the other hand, some constraints on budgetary flexibility may be a useful way to ensure that governments allocate revenues to goods and services for which taxpayers are willing to pay.”).

<sup>150</sup> For discussion of how the efficiency benefits of a user fee are limited when individuals must use the service, see, for example, Bird & Tsiopoulos, *supra* note 107, at 44 (“[U]ser charges in the context of inelastic demand have no efficiency rationale, since by definition they do not affect choices or activities.”); Gillette & Hopkins, *supra* note 83, at 811 (“Put differ-

filing fee, and the amount of revenue to collect from the fee can be determined independently of the amount of the IRS's enforcement budget without sacrificing the potential efficiency gains often used as a justification for user fees.

### C. Efficiency (To a Lesser Degree)

Oftentimes user fees are implemented, primarily, with the goal of increasing efficiency. Imposing a fee on the users of a government service can lead to the government providing the service in an amount that is better aligned with public demand for the service.<sup>151</sup> Consider, again, the fee charged for government-provided transportation that funds the transportation budget to allow public demand for the service to determine how much of the service is offered.

However, efficiency, in the sense of the public transportation example, is not a goal of a tax return filing fee. The activities on which the fee is levied (reporting transactions on Schedule UTP, for instance) are required,<sup>152</sup>

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ently, a user fee has quite limited allocational effects when service demand is price inelastic.”).

<sup>151</sup> See, e.g., Bird & Tsiopoulos, *supra* note 107, at 28 (“The main economic rationale for user charges . . . is . . . to promote economic efficiency. Charges achieve this goal by both providing information to public sector suppliers about how much clients are actually willing to pay for particular services and by ensuring that citizens value what the public sector supplies at least at (marginal) cost.”); Duff, *supra* note 107, at 395–96 (“Among its advocates, benefit taxation is generally favoured on one or more of three grounds: (1) that benefit taxes and user fees advance economic efficiency by ensuring that scarce resources are allocated to their most highly valued uses, both within the public sector and between the public and private sectors; (2) that these levies also enhance the accountability of the public sector, making it more responsive to differing preferences and changes in the demand for publicly provided goods and services”); Gillette & Hopkins, *supra* note 83, at 801 (“[T]he decision to reject or employ a user fee is best viewed as based on a desire to induce a socially optimal amount of the underlying good or service.”); Kleiman, *supra* note 99, at 4–5 (“[T]he public finance literature . . . not[es] that user fees can improve public good provision by introducing market-like efficiency. . . . Fees provide government with both price and usage information, allowing agencies to tailor services to user demand and to reallocate resources to increase public wellbeing.”). Relatedly, imposing user fees may also be justified by the goal of conserving scarce resources. See, e.g., Kleiman, *supra* note 99, at 5 (“Fees can also reduce wasteful overconsumption of public goods by forcing users to internalize the costs of their use.”); Reynolds, *supra* note 99, at 388 (“An important consideration in the provision of local services may be the extent to which the government desires to limit consumption of resources. This may be based on: (1) general efficiency concerns about enhancing its ability to provide the best service at the lowest cost; (2) environmentally based goals to conserve resources and limit consumption; or (3) a more general aim to reduce the government’s need to expand its service capacity.”).

<sup>152</sup> For discussion of how the efficiency benefits of a user fee are limited when individuals must use the service, see, for example, Bird & Tsiopoulos, *supra* note 107, at 44 (“[U]ser charges in the context of inelastic demand have no efficiency rationale, since by definition they do not affect choices or activities.”); Gillette & Hopkins, *supra* note 83, at 811 (“Put differently, a user fee has quite limited allocational effects when service demand is price inelastic.”).

at least at the time that the taxpayer prepares its return.<sup>153</sup> Furthermore, the optimal level of this particular government service—the IRS examining consequences claimed on a tax return—does not, of course, depend on the demand for the service by the particular taxpayer whose tax consequences are to be examined given that such demand is, presumably, non-existent.

Although efficiency is not a primary goal of the tax return filing fee, the fee could create some beneficial incentives for taxpayers.<sup>154</sup> First, the tax return filing fee would represent an additional cost of engaging in complex transactions with uncertain tax consequences. Making a taxpayer pay for the costs imposed on the IRS by such a transaction could result in the taxpayer accounting for the tax return filing fee at the stage in time when the taxpayer decides whether to engage in the transaction. If the tax return filing fee causes the taxpayer to forego the transaction entirely, in some cases (when the transaction would not have been undertaken but for the resulting tax consequences, for instance), that outcome could be an incidental, positive effect of the fee. While this could be a positive effect if the transaction was not justified but for its tax benefits, it could be a negative effect if the transaction was beneficial on a pre-tax basis.<sup>155</sup>

Second, the tax return filing fee would represent an additional cost for a company required to file Schedule UTP of claiming tax consequences with respect to a transaction that are not “more likely than not” to be sustained (creating a tax position that must be reported on Schedule UTP).<sup>156</sup> As a result, the fee could prompt some taxpayers to take less aggressive tax reporting positions.<sup>157</sup>

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<sup>153</sup> When the relevant time frame is expanded, reporting is not required in the sense that the obligation to report could be avoided by either not engaging in the transaction or claiming tax consequences that are more likely to be sustained.

<sup>154</sup> In some cases, the fee might create undesirable incentives, but refraining from levying the fee on deductions and credits used to encourage various activities could mitigate that possibility.

<sup>155</sup> This possibility might be mitigated because, if the transaction does produce non-tax benefits, in some cases the taxpayer could opt to proceed with the transaction but take a more conservative tax reporting position (thereby avoiding the fee) provided that the additional tax liability resulting from the more conservative reporting position did not discourage the transaction. Furthermore, while the proposal’s effects on efficiency are unclear, efficiency is not its primary goal.

<sup>156</sup> For discussion of what must be reported on Schedule UTP, see *supra* notes 62–64 and accompanying text.

<sup>157</sup> For discussion of this potential effect of requiring Schedule UTP in the first place, see Wells, *supra* note 32, at 415 (“This further internal rigor along with the added disclosure of the soft spots in the taxpayer’s tax return may (in combination) cause taxpayers to become more conservative with respect to the tax positions taken on their tax return. It would be a benefit to the country if taxpayers minimized the instances in which they claimed tax positions that in their own judgment are unsustainable.”). It is possible that the fee might also incentivize opinion inflation—pressure on tax advisors to reach opinions that tax consequences are more likely than not to be sustained. However, existing constraints—such as the regulations governing tax opinions contained in Circular 230—may mitigate this risk. For those regulations, see Circular No. 230, 31 C.F.R. §§ 10.0–10.93 (2014).

Finally, in some cases, the tax return filing fee might induce more taxpayers who engage in transactions with uncertain tax consequences to seek a letter ruling ahead of time, if the letter ruling fee would otherwise have been the main impediment to seeking a ruling.<sup>158</sup> With a tax return filing fee in place, some taxpayers will face a similar fee whether they seek a letter ruling (and pay a fee for requesting the ruling) or not (and pay, instead, a tax return filing fee as a result of claiming an uncertain tax position).<sup>159</sup> Such taxpayers might be more inclined to seek rulings, and, as discussed above, letter rulings offer benefits to other taxpayers and the IRS.<sup>160</sup>

## VI. CONCLUSION

To supplement the IRS's limited resources and to adjust for the varying difficulty of auditing different taxpayers, this Article proposes that Congress institute a tax return filing fee. The fee would generally increase with the difficulty of auditing each taxpayer, carving out certain difficult-to-audit items that lower-income taxpayers disproportionately claim. To make the fee administrable, the amount of the fee would be linked to items that taxpayers must already report. To avoid counterproductively exacerbating underreporting, the fee would not be linked to the amount or type of income reported. Initially, the scope of the fee could be limited to taxpayers who file Schedule UTP and based upon the number of uncertain tax positions reported on that schedule. The fee could potentially be expanded to taxpayers who claim certain deductions and credits that are not verifiable with third-party reporting.

In addition, future improvements to the accuracy of the fee could accompany more refined disclosure requirements. As lawmakers adopt more detailed disclosure requirements to make audits more effective, Congress

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<sup>158</sup> This effect would be muted because there are a number of other potential obstacles to seeking a ruling, including the time involved, the costs of preparing the request, and the fact that the IRS will not issue rulings on certain issues. Regarding this last issue, the IRS will not rule on certain specified topics for a variety of reasons, including concern that, in the case of some topics, determinations are too uncertain given the "factual nature" of the matter involved. Rev. Proc. 2020-3, 2020-3 I.R.B. 131. The list of topics on which the IRS will not rule expands periodically as the IRS appends other topics to the list, citing to resource constraints or other factors. *See id.*

<sup>159</sup> If the tax return filing fee is limited to tax positions reported on Schedule UTP, it may not induce many taxpayers to seek a letter ruling because they may prefer to take their chances on audit. However, if disclosure requirements are expanded in the future, and corresponding modifications are made to the tax return filing fee so that it applies to a wider range of transactions (but exempts any transactions that are the subject of letter rulings), then the tax return filing fee could have a greater potential to induce taxpayers to seek more letter rulings. For discussion of the possibility of expanded disclosure requirements and related alterations to the tax return filing fee, see *supra* notes 119-120 and accompanying text. Even with a tax return filing fee, some factors that might discourage seeking a letter ruling would remain. For discussion of these factors, see, for example, Yehonatan Givati, *Resolving Legal Uncertainty: The Unfulfilled Promise of Advanced Tax Rulings*, 29 VA. TAX REV. 137, 156-163 (2009).

<sup>160</sup> *See supra* notes 90, 92 and accompanying text. Taxpayers seeking more rulings would also impose additional costs on the IRS, but that could be ameliorated by adjusting the ruling request fee or adding items to the no ruling list.



could use that information to further refine the method for calculating the tax return filing fee by tying it to return items that are more accurate proxies for the difficulty of audit. Admittedly, it seems unlikely that Congress would adopt such a fee currently. However, a future Congress more receptive to increasing funding for the IRS ought to consider the fee as one way to help accomplish that objective.

