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## REVISING FORM 1040 FOR THE TWENTY-FIRST CENTURY

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### **Abstract**

Since the introduction of Form 1040 early in the last century, the form has largely remained unchanged. However, recent social science research demonstrates that the ways in which tax returns are structured and tax questions are asked can dramatically affect the responses of taxpayers. There is also strong evidence that most taxpayers now prepare their returns with computer software. In light of these developments, this Article argues that the contents of Form 1040 should be revised. In particular, new questions should be strategically and prominently placed on the form. This is not an exercise in mere aesthetics. If handled properly, the by-product of this revision could be greater taxpayer honesty and improved information for the Internal Revenue Service, both of which could yield billions of dollars of additional revenue without raising tax rates.

Keywords: Internal Revenue Service, tax compliance, behavioral economics, nudges, act of omission, act of commission

JEL codes: H2, H26, D91

# REVISING FORM 1040 FOR THE TWENTY-FIRST CENTURY

James Alm, Jay A. Soled, & Kathleen DeLaney Thomas\*

## ABSTRACT

Since the introduction of Form 1040 early in the last century, the form has largely remained unchanged. However, recent social science research demonstrates that the ways in which tax returns are structured and tax questions are asked can dramatically affect the responses of taxpayers. There is also strong evidence that most taxpayers now prepare their returns with computer software. In light of these developments, this Article argues that the contents of Form 1040 should be revised. In particular, new questions should be strategically and prominently placed on the form. This is not an exercise in mere aesthetics. If handled properly, the by-product of this revision could be greater taxpayer honesty and improved information for the Internal Revenue Service, both of which could yield billions of dollars of additional revenue without raising tax rates.

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## INTRODUCTION

The nation's premier tax return—the individual income tax Form 1040—has largely remained unchanged since it was first put into place well over a century ago. At that time, computers were nonexistent, and all submissions were handled via paper. However, in the intervening years, technology has fundamentally shifted the world of tax preparation, and the vast majority of taxpayers now use computer software to prepare and electronically submit their tax returns.<sup>1</sup> In addition, recent social science research (especially in behavioral economics) has provided convincing evidence that the ways in which tax returns are structured, and tax questions are asked, can have significant effects on how taxpayers respond to these questions.

These two developments—the fundamental shift in the individual tax preparation process and the evidence that the form of the tax return matters—have important implications. From a

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<sup>1</sup> See *Returns Filed, Taxes Collected, and Refunds Issued*, IRS DATA BOOK 2021, at tbl.4 (2021), <https://www.irs.gov/statistics/returns-filed-taxes-collected-and-refunds-issued> (for fiscal year 2021, indicating that 90 percent of individual returns were filed electronically).

logistical perspective, tax return preparation has never been quicker or easier. In most instances, data entry can be managed by simply uploading information from third-party tax information returns (e.g., Form W-2s and Form 1099s), and coding permits mathematical computations to be handled automatically.<sup>2</sup> For many taxpayers, a process that was once onerous and time-consuming can now be readily accomplished.

In combination with the growing evidence from behavioral economics that the structure of tax returns matters for taxpayer decisions, this shift in tax return preparation presents a yet untapped opportunity to strategically revamp Form 1040 to induce greater tax compliance. Specifically, we propose that a revised Form 1040 should include the addition of new, direct, and prominent questions to which taxpayers must affirmatively respond, thus preventing them from engaging in selective acts of omission when it comes to reporting income and other pertinent information. This approach to encouraging honesty by soliciting acts of commission is backed by compelling social science research.<sup>3</sup>

In the next section, this Article provides a rationale for why changes to Form 1040 are needed: the nation's tax gap—the difference between what taxpayers legally owe in taxes and what they actually pay<sup>4</sup>—remains stubbornly stuck in the low 80 percent range.<sup>5</sup> The following two sections recommend, based on social science research and U.S. case studies, respectively, that Form 1040 be redesigned to ask penetrating questions that taxpayers must answer (acts of commission rather than acts of omission) and to warn of possible unwelcome consequences (penalties) if taxpayers are deceitful. To highlight the practicality of this recommended reform, this Article then offers specific suggestions of exactly what those questions would be and how they

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<sup>2</sup> See, e.g., Glenn Kessler, *Claims About the Cost and Time It Takes to File Taxes*, WASH. POST (Apr. 15, 2013), [https://www.washingtonpost.com/blogs/fact-checker/post/claims-about-the-cost-and-time-it-takes-to-file-taxes/2013/04/13/858a97fc-a455-11e2-9c03-6952ff305f35\\_blog.html](https://www.washingtonpost.com/blogs/fact-checker/post/claims-about-the-cost-and-time-it-takes-to-file-taxes/2013/04/13/858a97fc-a455-11e2-9c03-6952ff305f35_blog.html) (“[S]ophisticated tax software in recent years has certainly eased the burden of endless calculations.”).

<sup>3</sup> See, e.g., Justin E. Holz, John A. List, Alejandro Zentner, Marvin Cardoza, & Joaquin Zentner, *The \$100 Million Nudge: Increasing Tax Compliance of Businesses and the Self-Employed Using a Natural Field Experiment* 3 (Becker Friedman Inst., Working Paper No. 2020-113, 2020), [https://bfi.uchicago.edu/wp-content/uploads/BFI\\_WP\\_2020113.pdf](https://bfi.uchicago.edu/wp-content/uploads/BFI_WP_2020113.pdf); Michael Hallsworth, John A. List, Robert Metcalfe, & Ivo Vlaev, *The Making of Homo Honoratus: From Omission to Commission* (Nat'l Bureau of Econ. Rsch., Working Paper No. 21210, 2015).

<sup>4</sup> See generally Robert E. Brown & Mark J. Mazur, *IRS's Comprehensive Approach to Compliance Measurement*, 56 NAT'L TAX J. 689 (2003); Mark J. Mazur & Alan H. Plumley, *Understanding the Tax Gap*, 60 NAT'L TAX J. 569 (2007); Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL'Y REV. 7 (2009); Eric Toder, *What Is the Tax Gap?*, 117 TAX NOTES 367 (2007).

<sup>5</sup> See Eric Toder, *Reducing the Tax Gap: The Illusion of Pain-Free Deficit Reduction*, 2007 TAX NOTES TODAY 130-22 (“With the caveat that estimates are very imprecise and the degrees of imprecision can change, we note that the measured tax gap has been quite stable over time in relation to ‘true’ tax liability.”). The IRS Commissioner recently estimated that tax cheating costs the U.S. \$1 trillion per year. See Alan Rappeport, *Tax Cheats Cost the U.S. \$1 Trillion per Year*, N.Y. TIMES (Oct. 13, 2021), <https://www.nytimes.com/2021/04/13/business/irs-tax-gap.html>.

would be placed, using a prototype of a revised Form 1040 to illustrate these points. Finally, this Article concludes.

## BACKGROUND AND THE NEED FOR REFORM

For many decades, the Internal Revenue Service (IRS) has routinely measured the size of the nation's tax gap.<sup>6</sup> This evidence indicates that the size of the tax gap has been largely constant over time, hovering around the range of 82 to 85 percent compliance.<sup>7</sup>

This is not to say that no efforts have been made to narrow the tax gap. To the contrary, Congress and the IRS have made numerous attempts to help taxpayers faithfully fulfill their civic duties. For example, at virtually every opportunity in which it has proven logistically possible, Congress has introduced third-party tax information returns, such as Form W-2s and Form 1099s, which have proven pivotal in Congress's quest for taxpayer compliance.<sup>8</sup> Likewise, Congress has mandated that tax return preparers submit prepared returns electronically (i.e., via magnetic media or in other machine-readable form),<sup>9</sup> making them far easier for the IRS to process and audit. The IRS, too, is doing its part to bolster tax compliance, employing sophisticated techniques such as data analytics to help identify those tax returns that might be suspect in nature.<sup>10</sup>

Notwithstanding the promising progress that these compliance efforts have yielded in closing the tax gap, there have also been multiple countervailing forces at work. In yesteryear, a cash economy had plagued tax compliance as many taxpayers were less than forthright in their tax-reporting practices and there was no "paper trail" that enabled IRS auditors to verify this

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<sup>6</sup> See generally Robert E. Brown & Mark J. Mazur, *The National Research Program: Measuring Taxpayer Compliance Comprehensively*, 51 UNIV. KAN. L. REV. 1255 (2003) (describing the history of the Taxpayer Compliance Measurement Program (TCMP)).

<sup>7</sup> See INTERNAL REVENUE SERVICE, PUBLICATION 1415: FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2014–2016 (2022), at 10, <https://www.irs.gov/pub/irs-pdf/p1415.pdf> (last visited Dec. 2, 2022).

<sup>8</sup> See *id.* at 2 ("Misreporting of income amounts subject to substantial information reporting and withholding is 1 percent of income. For amounts subject to substantial information reporting but not withholding, it is 6 percent; and for income amounts subject to little or no information reporting, such as nonfarm sole proprietor income, it is 55 percent."); Jay A. Soled, *Homage to Information Returns*, 27 VA. TAX REV. 371 (2007) (illustrating that the presence of third-party information returns fosters compliance).

<sup>9</sup> See I.R.C. § 6011(e).

<sup>10</sup> See, e.g., Carina Federico & Travis Thompson, *Do IRS Computers Dream About Tax Cheats? Artificial Intelligence and Big Data in Tax Enforcement and Compliance*, J. TAX PRAC. & PROC. 43 (2019) ("[T]he U.S. government has implemented advanced technology platforms to enforce financial crimes which have increased in sophistication."); Lynnley Browning, *Computer Scientists Wield Artificial Intelligence to Battle Tax Evasion*, N.Y. TIMES (2015), <https://www.nytimes.com/2015/10/10/business/computer-scientists-wield-artificial-intelligence-to-battle-tax-evasion.html> (describing research of how artificial intelligence has the ability to ferret out tax shelter activity).

noncompliance.<sup>11</sup> Gradually, electronic payments via credit cards have become more commonplace, curtailing the opportunity for taxpayers to camouflage their earnings.<sup>12</sup> However, as the use of cryptocurrency and payment platforms such as Venmo become more routine, the relative privacy associated with these modes of payment may trigger a resurgence in tax noncompliance.<sup>13</sup> Beyond the use of these virtual payment modes, the world has become increasingly global, making it easier for taxpayers to hide income in offshore jurisdictions.<sup>14</sup> In addition, the international banking and financial systems have devised exotic and complex financial products that can readily produce putative tax savings in ways that often have proven illegitimate.<sup>15</sup> Finally, IRS budgets and employment have shrunk significantly in the last ten years, reducing the agency's ability to enforce the tax laws.<sup>16</sup>

Recently, Congress has sought to address the IRS funding issue and narrow the tax gap in the traditional manner—that is, utilizing the threat of taxpayer audits as a means of enhancing deterrence.<sup>17</sup> In the Inflation Reduction Act of 2022,<sup>18</sup> Congress dedicated an additional \$80 billion for IRS funding over the next ten years to be used in part to augment its oversight capacities.<sup>19</sup>

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<sup>11</sup> See, e.g., Susan Cleary Morse, Stewart Karlinsky & Joseph Bankman, *Cash Businesses and Tax Evasion*, 20 STAN. L. POL'Y REV. 37, 37 (2009) (“According to government reports, most individuals with business income fail to pay all their taxes, although some appear to cheat more than others. Underpayment of tax on business income is commonly attributed to the receipt of cash.”).

<sup>12</sup> See James Alm & Jay A. Soled, *W(h)ither the Tax Gap?*, 92 WASH. L. REV. 521 (2017) (detailing the popularity of credit card use).

<sup>13</sup> See, e.g., Caroline T. Parnass, *Pay Toll with Coins: Looking Back on FBAR Penalties and Prosecutions to Inform the Future of Cryptocurrency Taxation*, 55 GEO. L. REV. 359 (2020) (“[F]ew people are reporting cryptocurrency transactions on their tax returns.”).

<sup>14</sup> See Tracy A. Kaye, *The Offshore Shell Game: U.S. Corporate Tax Avoidance Through Profit Shifting*, 18 CHAP. L. REV. 185 (2014) (explaining the ease with which U.S. corporations may shift profits to low-taxing foreign jurisdictions).

<sup>15</sup> See, e.g., Leandra Lederman, *A Tisket, a Tasket: Basketing and Corporate Tax Shelters*, 88 WASH. UNIV. L. REV. 557 (2011) (describing a panoply of various tax shelters).

<sup>16</sup> See IRS DATA BOOK 2021, at tbl.31, <https://www.irs.gov/pub/irs-pdf/p55b.pdf> (last visited Dec. 2, 2022) (indicating that the IRS budget fell in inflation-adjusted terms from \$15 billion in 2012 to \$12 billion in 2018 (with some increase in the last three years), and that the number of IRS employees fell from about 90,000 in 2012 to under 75,000 in 2018 (again, some increase since 2018)).

<sup>17</sup> See, e.g., Leandra Lederman, *Does Enforcement Reduce Voluntary Tax Compliance?*, 2018 B.Y.U. L. REV. 623 (2018) (describing how the threat of deterrence works in practice).

<sup>18</sup> See Pub. L. No. 117-169, 136 Stat. 1818 (signed Aug. 16, 2022).

<sup>19</sup> See Jacob Bogage, *Democrats' \$80 Billion Wager: A Bigger IRS Will Be a Better IRS*, WASH. POST (2022), <https://www.washingtonpost.com/business/2022/08/06/inflation-reduction-act-irs/> (“A newly empowered Internal Revenue Service is one of the keys to the sweeping climate, health care and tax bill Senate Democrats hope to pass this week—with billions of dollars in new funds for the agency so it can collect money for the federal government by going after higher-income tax cheats.”).

Based upon revenue projections, this expenditure is supposed to result in an additional \$203 billion of tax collections over this period.<sup>20</sup>

On the face of it, the funds that Congress is dedicating to the IRS appear likely to produce a worthwhile return on investment. The question that remains unanswered is whether there are low-cost alternatives that could further improve tax compliance. The tax return questions that we propose are such an alternative.

## SOCIAL SCIENCE RESEARCH AND ITS POTENTIAL TO SHAPE TAX REFORM

Social scientists have long researched those factors that shape humans' propensity to be ethical. While there are many factors that may come into play, one is whether a person's unethical behavior involves an *act of commission* or an *act of omission*: individuals are more likely to behave unethically if they can do so through an act of omission as opposed to an act of commission. For example, one study shows that people think it would be far worse for a tennis player to actively instruct her opponent to eat food that the former knew to be tainted (an act of commission) than to simply not stop her opponent from eating the tainted food (an act of omission).<sup>21</sup> Similarly, humans tend to be more psychologically at ease neglecting to tell the truth (omission) as opposed to lying (commission).<sup>22</sup>

There are two main reasons that humans favor acts of omission and avoid those of commission.

First, humans tend to exhibit what is known as "cognitive miserliness." When we lie, "[n]euroimaging studies have shown that people's brains show considerably more activity . . . particularly in the prefrontal cortex, suggesting that lying requires extra cognitive control and inhibition of truth-telling."<sup>23</sup> Acts of omission do not have this same enervating effect. Perhaps hearkening back to our heritage as hunter-gatherers, we much prefer, as a species, to conserve our cognitive energies.<sup>24</sup>

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<sup>20</sup> *Id.* ("An analysis conducted by the Congressional Budget Office, the legislature's nonpartisan bookkeeper, found the IRS provisions would knock \$203 billion off the federal deficit, far more than what Democrats expected when they introduced the bill.")

<sup>21</sup> See Mark Spranca, Elisa Minsk & Jonathan Baron, *Omission and Commission in Judgment and Choice*, 27 J. EXPERIMENTAL SOC. PSYCH. 76 (1991).

<sup>22</sup> See Andrea Pittarello, Enrico Rubaltelli & Daphna Motro, *Legitimate Lies: The Relationship Between Omission, Commission, and Cheating*, 46 EUR. J. SOC. PSYCH. 4 (2015).

<sup>23</sup> See Anil Ananthaswamy, *The More You Lie, the Easier It Gets*, NEWSIDENTIST (Feb. 8, 2011), <https://www.newscientist.com/article/dn20085-the-more-you-lie-the-easier-it-gets/#:~:text=Neuroimaging%20studies%20have%20shown%20that,longer%20than%20telling%20the%20truth.>

<sup>24</sup> See Juan Silezar, *Why Run Unless Something Is Chasing You*, HARV. GAZETTE (2021), <https://news.harvard.edu/gazette/story/2021/01/daniel-lieberman-busts-exercising-myths/> ("[B]iologist Daniel E. Lieberman '86 says[] we're nearly hard-wired to avoid unnecessary exertion.").

Second, humans tend to avoid “cognitive dissonance,” or the projection of a public image inconsistent with who they truly are.<sup>25</sup> As part of the avoidance process, we will rationalize our behavior to maintain a positive self-image.<sup>26</sup> When someone lies outright, the rationalization process is a difficult mental journey to undertake, and it is usually out of sync with the image of virtue that most people wish to project. By comparison, when someone omits telling the truth, rationalizations are generally far easier to formulate (e.g., people might rationalize that because the questionnaire did not raise a particular issue, it must not be important to those soliciting a response).

These findings have enormous implications for tax compliance because the current Form 1040 by its very nature tacitly invites unethical acts of omission. For example, taxpayers can simply “forget” to include various sources of income (e.g., income from a cash business) when reporting total income on their tax return. This problem is exacerbated by tax preparation software because taxpayers have the option to forgo “interview-style” questions and can simply choose those items on the software menu that they wish to populate. For example, a taxpayer might choose “W-2” and “Form 1099-INT” for income sources and so choose not to visit a section titled “Other Income.” Given what we know about how acts of omission ease cognitive burdens for taxpayers, this tax return format may well encourage more underreporting.

Two recent real-world studies underscore the importance of the omission/commission distinction in the realm of tax compliance. In the United Kingdom, researchers found that sending a letter to delinquent taxpayers stating that the government would treat nonresponse as an “active choice” nearly doubled the payment rate for these taxpayers relative to other taxpayers who simply got the standard notice of delinquency.<sup>27</sup> Similarly, in the Dominican Republic, a letter sent to taxpayers emphasizing that late tax payment was an act of commission was highly effective at improving tax collections when the commission message was paired with a reminder of potential penalties for noncompliance.<sup>28</sup>

The implications of this social science research are compelling and important.<sup>29</sup> There is a simple way to implement these findings to improve tax compliance in the United States: tax returns should ask more penetrating questions that engender acts of commission rather than providing

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<sup>25</sup> See Saul McLeod, *Cognitive Dissonance*, SIMPLYPSYCH. (2018), <https://www.simplypsychology.org/cognitive-dissonance.html> (“Cognitive dissonance refers to a situation involving conflicting attitudes, beliefs or behaviors. This produces a feeling of mental discomfort leading to an alteration in one of the attitudes, beliefs or behaviors to reduce the discomfort and restore balance.”).

<sup>26</sup> See Jennifer Tzeses, *Tell Me Everything I Need to Know About Cognitive Dissonance*, PSYCOM (2021), <https://www.psychom.net/cognitive-dissonance> (“Dissonance can be reduced by changing existing beliefs, adding new beliefs, or minimizing the importance of the beliefs.”).

<sup>27</sup> See Hallsworth et al., *supra* note 3.

<sup>28</sup> See Holz et al., *supra* note 3.

<sup>29</sup> We detail the social science literature on the omission versus commission distinction in more detail in a forthcoming article entitled *Multibillion-Dollar Tax Questions*.

opportunities to taxpayers to omit information.<sup>30</sup> In a world in which tax return preparation has become streamlined, this occasion for reform should not be forfeited.

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<sup>30</sup> See Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1733 (2010) (explaining that a “core problem for enforcement of tax laws is asymmetric information”).



## SUCCESSFUL CASE STUDIES IN THE UNITED STATES

There are several case studies that illustrate the power of asking penetrating tax return questions. Consider two such examples.

1. Case Study #1: Request for Dependents' Social Security Numbers. For many years, the IRS would conduct audits and learn that taxpayers were claiming nonexistent children and their pets as dependents.<sup>31</sup> To curtail this practice, as part of the Tax Reform Act of 1986, Congress instituted the requirement that the Social Security number of any listed dependent age five or older be reported.<sup>32</sup> In light of this legislative initiative, going forward, all Form 1040s required this information. In response, seven million putative dependents suddenly disappeared into thin air in the year after its enactment, resulting in an additional \$3 billion of annual tax revenue.<sup>33</sup> This legislation proved so successful that, in later reform initiatives, Congress lowered the age restriction for reporting dependents<sup>34</sup> and then eliminated the age restriction altogether.<sup>35</sup> It should be noted that this relatively simple reform was successful even before the advent of automated computer matching of tax return information with IRS records. This suggests that the mere act of soliciting the information contributed to taxpayers' honesty, even without expensive and time-consuming audits.

2. Case Study #2: Request for Childcare Employer Identification Numbers. Under the Code, qualified taxpayers may secure a credit for so-called employment-related expenses (often in the nature of childcare) expended on behalf of a qualifying individual, namely, a dependent under the age of 13 or a spouse who is physically or mentally incapable of caring for himself or herself.<sup>36</sup> While many taxpayers sought to capitalize upon this credit, some childcare providers were fictitious or, alternatively, not reporting the income that they were receiving.<sup>37</sup> Congress decided

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<sup>31</sup> See *The IRS' Case of Missing Children*, L.A. TIMES (1989), <https://www.latimes.com/archives/la-xpm-1989-12-11-me-33-story.html> (“For a lot of years, millions of children were apparently and profitably created not in the usual way but solely through acts of imagination.”).

<sup>32</sup> See Tax Reform Act of 1986, Pub. L. No. 99-514, § 1524(a), 100 Stat. 2085, 2749 (I.R.C. § 6109(e) before repeal in 1996).

<sup>33</sup> See Stephen J. Dubner & Steven D. Levitt, *Filling the Tax Gap*, N.Y. TIMES (2006), <https://www.nytimes.com/2006/04/02/magazine/filling-in-the-tax-gap.html> (after the institution of this legislation, “seven million dependents had suddenly vanished from the tax rolls, some incalculable combination of real pets and phantom children, ... generat[ing] nearly \$3 billion in revenues in a single year.”).

<sup>34</sup> See Family Support Act of 1988, Pub. L. No. 100-485, § 704, 102 Stat. 2343, 2427–28.

<sup>35</sup> See Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1615, 110 Stat. 1755, 1853–54 (repealing I.R.C. § 6109(e); codified as amended in § 151(e)).

<sup>36</sup> See I.R.C. § 21(b)(1).

<sup>37</sup> See Tamar Lewin, *I.R.S. Sees Evidence of Wide Tax Cheating on Child Care*, N.Y. TIMES (1991), <https://www.nytimes.com/1991/01/06/us/irs-sees-evidence-of-wide-tax-cheating-on-child-care.html?searchResultPosition=1> (“The Internal Revenue Service has striking new evidence that large numbers of Americans have been cheating on their taxes, claiming deductions

to revisit a tried-and-true method of compliance: going forward, taxpayers wishing to use this credit would be required to report the employer identification numbers of those childcare providers whose services they used. With Form 1040 accordingly adjusted, the number of taxpayers reporting qualification for this tax credit dropped nearly 20 percent, from 8.7 million in 1988 to 6.1 million in 1989; and the corresponding “cost” to the federal government (i.e., fewer taxpayers availing themselves of this tax credit) plunged from \$3.7 billion in 1988 to \$2.5 billion in 1989.<sup>38</sup> Simultaneously, the number of childcare providers skyrocketed nearly 65 percent, from 262,000 in 1988 to 431,000 in 1989.<sup>39</sup>

In sum, these two case studies and others<sup>40</sup> illustrate the vast power of asking taxpayers questions that require them to engage in acts of commission rather than those of omission. They present a compelling argument in favor of tax returns asking penetrating and prominent questions that afford the IRS greater information to track possible taxpayer noncompliance. Revising Form 1040 to include such questions would encourage taxpayers to be more honest on their tax returns, potentially yielding billions of dollars of additional revenue.

## A FORM 1040 FOR THE TWENTY-FIRST CENTURY

Academics are renowned—or reviled—for proffering advice that is theoretically sound but often lacks practicality. This Article hopes to avoid this criticism. In this section, we suggest specific questions that Congress and/or the IRS should add to Form 1040, along with a visual depiction of how an overhauled Form 1040 would appear.

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for children who do not exist and child-care credits for baby sitters who are paid cash under the table.”).

<sup>38</sup> See *id.*; *Millions Cheat on Dependent Claim—IRS*, L.A. TIMES (1990), <https://www.latimes.com/archives/la-xpm-1990-11-16-fi-4934-story.html>.

<sup>39</sup> *Id.*

<sup>40</sup> For example, for many years Congress suspected that many taxpayers were failing to include on their tax return income earned overseas. Therefore, as part of the Bank Secrecy Act in 1970 (Pub. L. No. 91-508, tits. I, II, 84 Stat. 1114 (1970)), Congress decided to take definitive action, adding a requirement that taxpayers affirm or deny that they had authority over foreign accounts, resulting in the following question being placed on Schedule B of Form 1040: “At any time during 202[X], did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?” Unlike Case Study #1 and #2, this question yielded mixed results, at least in its early years of use: it likely caused some taxpayers to be more compliant, but a large number of taxpayers continued to lie, likely because they suspected that the IRS lacked the ability to verify the veracity of their responses. More recently, however, as a by-product of the Foreign Account Tax Compliance Act becoming fully effective and the IRS now having the tools to cross-check taxpayers’ responses, there are heightened expectations that this question will have new vigor. *DOJ Secures First Ever Conviction for Violating FATCA*, NAT’L REV. (Sept. 17, 2018), <https://www.natlawreview.com/article/doj-secures-first-ever-conviction-violating-fatca>; Jesse Drucker, *U.S. Prosecutors Bring Their First Charges over the Panama Papers*, N.Y. TIMES (Dec. 4, 2018), <https://www.nytimes.com/2018/12/04/business/panama-papers-indictment.html>.

The questions raised should have a specific purpose in mind, namely, to prod taxpayers to be compliant. Bearing this goal in mind, it is important to identify those areas in which tax compliance is lackluster. There are five areas that most commentators would agree require attention. These areas are as follows:

1. Cash and cash-equivalent payments<sup>41</sup>
2. Cryptocurrency<sup>42</sup>
3. Payments made to household employees<sup>43</sup>
4. Hidden foreign accounts<sup>44</sup>
5. Tax shelter activity<sup>45</sup>

Because of tax compliance issues associated with the five foregoing areas, the following five questions should be added to the face of Form 1040:<sup>46</sup>

1. *In 2022, aside from income reported on Form W-2 or Form 1099, did you receive any business-related cash or cash-equivalent payments (e.g., checks/virtual currency/payment apps such as Venmo)?* \_\_\_\_\_ Yes \_\_\_\_\_ No

*If you answered yes, how much? (Do not include any amounts that were reported on Form W-2 or Form 1099.)*

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<sup>41</sup> See Morse, Karlinsky & Bankman, *supra* note 11.

<sup>42</sup> See Greg Iacurci, *Cryptocurrency Poses a Significant Risk of Tax Evasion*, CNBC (2021), <https://www.cnbc.com/2021/05/31/cryptocurrency-poses-a-significant-risk-of-tax-evasion.html> (“Virtual currencies like bitcoin and ethereum, which are collectively valued around \$2 trillion, offer investors a way to shield income from tax authorities.”).

<sup>43</sup> See David Cay Johnston, *Despite an Easing of Rules, Millions Evade Nanny Tax*, N.Y. TIMES (1998), <https://www.nytimes.com/1998/04/05/business/despite-an-easing-of-rules-millions-evade-nanny-tax.html> (pointing out that when it comes to hiring household employees, tax compliance is abysmal).

<sup>44</sup> See Alexis Leondis, *Yes, You Can Still Hide Bank Accounts Offshore*, BLOOMBERG (2021), <https://www.bloomberg.com/opinion/articles/2021-12-03/yes-you-can-still-hide-bank-accounts-offshore> (“The U.S. government has worked hard over the past decade to stop Americans from hiding bank accounts offshore to evade taxes. But not hard enough. It has become more difficult to maintain secret accounts, but it’s still happening, as recent examples show.”).

<sup>45</sup> See Andrea Monroe, *What’s in a Name: Can the Partnership Anti-Abuse Rule Really Stop Partnership Tax Abuse?*, 60 CASE W. RES. L. REV. 401, 403–04 (2010) (“Thus, for taxpayers with enough sophistication or financial resources to exploit subchapter K’s complexity, partnerships offer plentiful opportunities to engage in strategic behavior. Indeed, many taxpayers consider partnerships the perfect vehicle for tax shelter activity: the rules are flexible, but also technical, and the entity is less likely to be audited than its transactional counterparts.”).

<sup>46</sup> Note that versions of questions 2 and 4, regarding virtual currency and foreign accounts, are already part of Form 1040. However, we suggest that these questions receive prominent placement with the other proposed questions and that tax preparation software also mandate responses (as discussed further below).

*How much of these payments did you deposit in financial institutions or hold in cryptocurrency?*

2. *In 2022, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? \_\_\_\_\_ Yes \_\_\_\_\_ No*

*If you answered yes, specify the amounts.*

3. *In 2022, did you pay any individual household worker (e.g., health-care aide/childcare provider) \$2,400 or more? \_\_\_\_\_ Yes \_\_\_\_\_ No*

*If you answered yes, you must complete Schedule H.*

4. *In 2022, did you have any financial interest in or signature authority over any financial accounts (bank accounts, securities accounts, or brokerage accounts) located in a foreign country? \_\_\_\_\_ Yes \_\_\_\_\_ No*

*If you answered yes, you must complete Part III of Schedule B.*

5. *In 2022, aside from transactions in publicly held stock and securities, did any investment you made or business venture you engaged in yield recognized losses in excess of \$500,000? \_\_\_\_\_ Yes \_\_\_\_\_ No*

*If you answered yes, what was the aggregate amount of such losses?*

Because of the importance of these particular questions, the IRS should mandate their completion and also remind taxpayers of the consequences associated with untrue responses. Accordingly, along with these questions, the following admonition should appear:

*Completion of these questions is required, and failure to accurately answer these questions may subject you to civil and/or criminal penalties.*

Admittedly, this warning is somewhat similar in tone to the attestation taxpayers must complete at the end of Form 1040.<sup>47</sup> However, as numerous social science research studies demonstrate, repetition serves a useful purpose by calling to the taxpayer's attention the significance of these questions.<sup>48</sup>

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<sup>47</sup> The attestation at the end of Form 1040 reads: "Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete."

<sup>48</sup> Some theorists advocate that taxpayers swear under penalties of perjury before filling out their tax returns. *See, e.g.,* Joseph Bankman, Clifford Nass & Joel Slemrod, *Using the "Smart Return" to Reduce Evasion and Simplify Tax Filing*, 69 TAX L. REV. 459, 466 (2016); Kathleen DeLaney Thomas, *The Psychic Cost of Tax Evasion*, 56 B.C. L. REV. 617, 648-49 (2015).

In order to emphasize the practicality of this proposal, at the end of this Article is an Exhibit that provides a visual of exactly how the front page of Form 1040 would look.

As a practical matter, notwithstanding the potential power of the proposed Form 1040, a paper rendition is fairly meaningless in the twenty-first century when most taxpayers use tax preparation software.<sup>49</sup> Accordingly, the IRS should mandate that tax software companies require taxpayers, immediately after entering their name, address, and other personal information, to respond to the foregoing questions and view the admonishment statement (preferably in bold red font) before proceeding to the balance of their tax return.<sup>50</sup> Requiring taxpayers to answer these questions would force taxpayers to engage in an act of commission, which should make them more reluctant to respond dishonestly. And mandating this format not only would highlight the importance of this information but also would call attention to the greater likelihood that the IRS would scrutinize it for its accuracy.

Making Form 1040 more effective in improving tax compliance would seem noncontroversial. Nevertheless, there are some taxpayers who might voice misgivings that the questions raised are too intrusive.<sup>51</sup> However, the proposed questions all relate to commerce of some sort, and, by their very nature, commercial transactions are not private. Another complaint might be that responding to these questions constitutes an undue administrative burden.<sup>52</sup> However, given the advanced state of technology and with software readily available for little monetary cost, the collection of this information can be accomplished with minimal administrative effort. When coupling this fact with the reality that tax return preparation can be handled at a fraction of the time that tax preparation required in yesteryear, responding to the five questions of the sort proposed here would hardly be unduly onerous for the average taxpayer.

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<sup>49</sup> See *supra* note 1 and accompanying text.

<sup>50</sup> The IRS must approve all tax preparation software for electronic filing. See *Publication 1436* for individual returns and *Publication 5078* for business returns. This part of the program that the IRS has instituted is known as the Modernized e-File or MeF system. *Modernized e-File (MeF) User Guides and Publications*, IRS.GOV, <https://www.irs.gov/e-file-providers/modernized-e-file-mef-user-guides-and-publications> (last visited Dec. 1, 2022).

<sup>51</sup> See, e.g., Michael Tennant, *IRS Becoming Big Brother with \$99-Million Supercomputer*, NEW AM. (Jan. 22, 2019), <https://perma.cc/M5R4-SLPN>; Kimberly A. Houser & Debra Sanders, *The Use of Big Data Analytics by the IRS: Efficient Solutions or the End of Privacy as We Know It?*, 19 Vand. J. Ent. & Tech. L. 817 (2017).

<sup>52</sup> See, e.g., Leslie Book, T. Keith Fogg & Nina E. Olson, *Reducing Administrative Burdens to Protect Taxpayer Rights*, 74 OKLA. L. REV. 527 (2022):

The tax system designed by Congress imposes significant administrative burdens on taxpayers. IRS decisions regarding how it administers tax laws can add to congressionally imposed burdens. The administrative burdens are consequential and hurt some people, especially lower- or moderate-income individual taxpayers, more than others. While the IRS strives to measure and reduce the time and money taxpayers spend to comply with their tax obligations, it does not consider the effect administrative burdens have on taxpayer rights, including the right to be informed, the right to pay no more than the correct amount of tax, and the right to a fair and just tax system.

## CONCLUSION

In the past several decades, proposed tax increases have been deemed by many politicians and commentators to be anathema to the vibrancy of the nation's economy.<sup>53</sup> That being the case, few such proposed tax increases have met with political traction. Nevertheless, the fiscal demands being placed on the federal coffers continue to grow. Such demands include, but are not limited to, those related to climate change, the demographics of an aging population, social welfare expansions, a global pandemic, and vast infrastructure.

As part of the Inflation Reduction Act of 2022, Congress sought to be fiscally responsible while simultaneously addressing some of the nation's most salient expenditure needs. The course that Congress took to balance these competing interests was to enhance IRS funding in hopes of narrowing the nation's tax gap.

This Article agrees with the philosophy advanced in the Inflation Reduction Act of 2022—that is, that the nation's tax gap needs to be narrowed and, that being the case, we applaud the fact that Congress decided to direct more robust funding to the IRS. We also believe that efforts to help narrow the tax gap should not end there, particularly when there are additional low-cost options available. Specifically, this Article advocates that, based on twenty-first-century technology and the findings of social science research, the anachronistic Form 1040 should be overhauled and populated with additional questions. Taking this step is not a fiscal panacea. However, this reform involves virtually no cost to the government, is administratively feasible, is easy in terms of taxpayer compliance, and can result in the collection of billions of dollars of additional revenue without raising tax rates. The only question that remains is a simple one: Why are Congress and the IRS waiting to act?

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<sup>53</sup> See Ezra Klein, *Why Does the GOP Hate Taxes So Much?*, WASH. POST (2011), [https://www.washingtonpost.com/blogs/wonkblog/post/why-does-the-gop-hates-taxes-so-much/2011/05/09/AFBBnMzG\\_blog.html](https://www.washingtonpost.com/blogs/wonkblog/post/why-does-the-gop-hates-taxes-so-much/2011/05/09/AFBBnMzG_blog.html) (“The GOP doesn’t just hate taxes. They hate taxes *so much* that their stated position is they’d prefer no deficit reduction, and even a default on the debt ceiling, to even a dollar in new taxes. They hate taxes, in other words, more than they like balanced budgets, or fear a federal default.” (emphasis in original)).