# Privacy and Tax Information Collection: A Response to Blank & Glogower

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*ABSTRACT: In a recent article published in the Iowa Law Review, Professors Joshua Blank and Ari Glogower proposed a new "actor-based" information reporting regime that would be more comprehensive, more difficult to avoid, and more equitable than the current approach. However, their proposal would create new privacy risks that are not implicated by the current regime. Privacy values are an important tax policy objective that must be analyzed along with the values of efficiency, equity, and administrability. Accordingly, this Essay draws on theory about tax privacy to analyze the privacy implications of actor-based reporting.*

*The Essay identifies several ways that actor-based information reporting may violate the privacy interests of high-end taxpayers. First, actor-based information reporting would be more coercive than prior law, forcing taxpayers to disclose financial information about themselves to third parties. Second, the proposed regime may break important income tax norms by collecting types of data that are not normally collected under the income tax laws. Third, emerging cybersecurity risks may call for heightened tax privacy and counsel against increased data collection, whereas the proposed regime would do the opposite.*

*The Essay then considers a less invasive alternative to actor-based reporting: an incentive-based approach. It argues that economic incentives can be used to nudge people to share relevant information with the IRS, and it provides three examples. These include incentives for taxpayers to report rent paid to landlords, incentives for tax insurance companies to report information about insured tax positions, and incentives for tax whistleblowers. These policies have privacy advantages over actor-based reporting, but they may perform less favorably in terms of equity, efficiency, or simplicity objectives. Ultimately, tax policymakers must decide whether the privacy risks of an actor-based approach are an acceptable cost of tax enforcement, or whether less invasive policies should be adopted despite their shortcomings.*

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## Introduction

Each year, hundreds of billions of dollars escape taxation due to nonfiling of taxes, underreporting of income, and underpayment.[1] The difference between the estimated tax liabilities during a period and the amount of tax paid on time is known as the "tax gap," and it has been growing in recent years.[2] The Internal Revenue Service ("IRS") projected that the annual tax gap reached $688 billion in 2021, a rise of more than $138 billion from the 2017–2019 projections.[3] As if this was not concerning enough, the IRS publication noted that "projections cannot fully represent noncompliance in some components of the tax system including offshore activities, issues involving digital assets and cryptocurrency as well as corporate income tax, income from flow-through entities and illegal activities because data [is] lacking."[4] In other words, the IRS is not only struggling to close the tax gap, but it is also suffering from a tax *information* gap.

In a recent Article published by the *Iowa Law Review*, Professors Joshua Blank and Ari Glogower demonstrated that the country's tax gap is inextricably

1. I.R.S. News Release IR-2023-187 (Oct. 12, 2023).
2. *Id.*
3. *Id.*
4. *Id.*

linked to the tax information gap.[5] They begin by noting that one of the agency's most effective enforcement tools is tax information reporting, whereby "a third-party intermediary, such as an employer or a bank, files an information return with both the individual taxpayer and the IRS" that discloses the taxable transaction.[6] When information reporting is available, the compliance rate is ninety-five percent.[7] But information reporting is *not* always available, and many transactions—including those cited by the IRS —take place beyond the gaze of the agency. In their Article, Blank and Glogower identify several holes in the information reporting regime and areas of noncompliance, and they explain how the resulting information tax gap tends to benefit high income and high net worth taxpayers.[8] Then, they propose an alternative "actor-based" information reporting regime that would be more comprehensive, more difficult to avoid, and more equitable than the current approach.[9]

Unlike the current information reporting regime, which requires information reporting about certain taxable activities, Blank and Glogower's actor-based regime would target only the wealthiest, highest income taxpayers.[10] These taxpayers, who Blank and Glogower refer to as "high-end taxpayers," would be subject to heightened information reporting requirements.[11] This would enable the IRS to collect valuable information about their asset holdings and cash inflows and outflows that is not collected under the current, activity-based regime.[12] Blank and Glogower present a convincing argument that such a regime would be more efficient, equitable, and simple than the status quo.

What Blank and Glogower do *not* discuss are the privacy implications of their proposal. This Response aims to fill that gap. Data privacy lies at the center of tax enforcement. As one scholar noted, the mounting pressure to close the tax gap by narrowing the related information gap points to a "practical need for a coherent privacy policy in taxation," and "privacy values are comparable to the values of efficiency, equity, and administrability that tax scholars have long heralded as markers of a sound tax system."[13] This Essay draws on theory about tax privacy to analyze the privacy implications of actor-based reporting. It identifies several ways that actor-based information reporting may violate the privacy interests of high-end taxpayers. First, actor-

5. *See generally* Joshua D. Blank & Ari Glogower, *The Tax Information Gap at the Top*, 108 IOWA L. REV. 1597 (2023) (arguing that activity-based tax information reporting rules should be supplemented with actor-based information reporting rules to prevent high-end taxpayers from engaging in tax noncompliance).

6. *Id.* at 1599.

7. *Id.*

8. *Id.* at 1617–28.

9. *See id.* at 1628–31.

10. *Id.* at 1628.

11. *Id.*

12. *See id.* at 1629.

13. Michael Hatfield, *Privacy in Taxation*, 44 FLA. ST. U. L. REV. 579, 581, 583 (2017).

based information reporting would be more coercive than prior law, forcing taxpayers to disclose financial information about themselves to third parties. Second, the proposed regime may break important income tax norms by collecting types of data that is not normally collected under the income tax laws. Permissive tax privacy norms are based on the activity-based status quo, but actor-based reporting would depart from the status quo in important ways. Third, emerging cybersecurity risks may call for heightened tax privacy and counsel against increased data collection, whereas the proposed regime would do the opposite.

After analyzing the privacy implications of actor-based reporting, this Response considers a less invasive alternative: an incentive-based approach. It argues that economic incentives can be used to nudge people to share relevant information with the IRS, and it provides three examples. The first example demonstrates how renters' tax credits could be used to fill a significant gap in the information reporting regime: rental income received by landlords. The second example draws on research by Professor Heather Field to demonstrate how private market incentives related to tax insurance can be leveraged for information collection purposes. The third example shows how existing incentives for tax whistleblowers can be strengthened to help detect noncompliance. In each case, this Essay will consider privacy risks. None are without risks, but each has at least some privacy advantages over actor-based reporting.

Here, a caveat is in order. The purpose of this Essay is not to question the wisdom of actor-based reporting, nor is it to suggest that an incentive-based approach would be a better policy choice. Just as tax policymakers must balance competing objectives of efficiency, equity, and simplicity—and they can rarely achieve all at once—policymakers should consider whether the privacy risks described in this Essay are an acceptable cost of tax enforcement. The modest goal of this Essay is to surface privacy issues that are relevant to evaluate proposals to collect tax information. *Some* privacy violations are inevitable in tax enforcement, and perfect privacy may well lead to inefficient and inequitable outcomes. Nevertheless, as the government's capacity to collect information increases, and as the pressure to close the tax information gap mounts, it will be essential for policymakers to confront the privacy issues raised by tax information collection.

This Article proceeds as follows. Part I provides a brief summary of Blank and Glogower's Article, *The Tax Information Gap at the Top*. It reviews the problems with the current information reporting regime, and it describes their proposed solution, actor-based information reporting. Part II turns its attention to tax privacy. It begins by reviewing the literature on tax privacy and the theory underlying a tax privacy objective. Then, it considers the privacy implications of actor-based information reporting. Part III presents a less invasive approach that relies on economic incentives to collect relevant information. It argues that the incentive-based approach may have privacy advantages over actor-based reporting. The Essay concludes with a general

call for scholars and lawmakers to incorporate privacy analyses their policy proposals.

## I. THE TAX INFORMATION GAP AT THE TOP

Blank and Glogower's Article begins with an analysis of the information reporting regime as it exists today.[14] Through a series of examples, they demonstrate that tax enforcement relies heavily upon information reporting that alerts the IRS to taxable activities, but significant gaps in the information reporting framework tend to benefit the wealthy.[15] Their analysis points to two significant types of gaps in the existing activity-based reporting regime. The first are holes in the information reporting regime itself. Some activities simply are not covered by the existing framework, and the law allows them to go unreported. The second arises from noncompliance with the information reporting regime. In these instances, the law may *require* information reporting, but taxpayers and their affiliates have found ways to evade those requirements. This Part will begin by reviewing these gaps in the reporting framework that Blank and Glogower identified, and then it will introduce their proposed corrective: actor-based information reporting.

### A. *THE TROUBLE WITH ACTIVITY-BASED REPORTING*

#### 1. Holes in the Information Reporting Regime

Information reporting is not required for all income-producing transactions, and these holes in the information reporting regime contribute to the tax information gap. Blank and Glogower offer multiple examples. First, business income earned by "individuals who are not employees, but instead, who own and operate their own businesses, either as sole proprietorships or through business entities" often escapes information reporting.[16] For example, a wealthy individual who owns and manages rental properties is not subject to information reporting with respect to rental income.[17] There simply "is no 'IRS Form 1099-RENT.'"[18] As a result, the IRS does not regularly collect information about rental income, and this makes it more challenging for the IRS to detect when taxpayers are underreporting this income. To catch this kind of noncompliance, the IRS would have to engage in audits, but many wealthy individuals earn their business income through passthrough entities, and the IRS does very little auditing of these entities.[19]

Blank and Glogower also point to cases when transactions are exempt from information reporting when certain types of taxpayers are a party. Three examples illustrate this point. First, under the standard information reporting

14. Blank & Glogower, *supra* note 5, at 1605–11.
15. *See id.* at 1617–28.
16. *Id.* at 1618.
17. *Id.*
18. *Id.* (quoting I.RC. §§ 6041–6050W).
19. *Id.* at 1619.

rules, when a person engaged in a trade or business pays a non-employee more than six hundred dollars for services, they must file an information report.[20] However, no information report is required if the service provider is a corporation (including an S-Corporation).[21] Second, under the standard information reporting rules, a payor of interest must report the payments on a Form 1099-INT. However, "this requirement does not apply when the interest payee is a corporation."[22] Third, although a sale, exchange, and disposition of assets made *through a broker* would be subject to information reporting on an IRS Form 1099-B, other sale transactions are not subject to third-party information reporting.[23] For example, sales of S-corporation shares or partnership interests may take place without a broker. In these cases, no information return would be filed to describe the transaction.[24] Meanwhile, neither the IRS Schedule K-1 Form 1120-S (filed by S corporations) nor the IRS Schedule K-1 Form 1065 (filed by partnerships) include outside basis figures.[25] As a result, owners of these passthrough entities may be able to manipulate their basis to evade taxes when they sell their interest in the company.[26]

In sum, the information reporting regime fails to capture some income because the law does not require third-party reporting of that income. These holes contribute to the tax information gap at the top. However, as the next Section will explain, the information reporting regime also fails to capture some income that *is* legally required to be reported.

### 2. Non-Compliance with Information Reporting Rules

Even when information reporting is legally required, there are often compliance and enforcement issues associated with information reporting itself. Blank and Glogower provide several examples. The first relates to offshore accounts.[27] When taxpayers shift earnings offshore, those activities often escape information reporting *even though* the law requires financial institutions to report information about these accounts.[28] A common strategy wealthy individuals use to evade taxes is to "divert[] earnings from U.S. sources into offshore trusts and bank accounts."[29] Historically, "financial institutions outside of the United States, such as UBS, used local bank secrecy rules as a

20. *Id.* at 1623.
21. *Id.*
22. *Id.* at 1625.
23. *Id.* at 1627.
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.* at 1619.
28. *Id.* at 1619–20.
29. *Id.* at 1619.

reason for not reporting information about these accounts to the IRS."[30] As a result, no information reporting was available for these transactions.

In 2010, the United States enacted an information reporting regime, Foreign Account Tax Compliance Act ("FATCA"), to require financial institutions to report "identifying information and account balance information regarding U.S. account holders."[31] To increase compliance, the law imposes a thirty percent withholding tax on certain U.S.-source payments made to noncomplying financial institutions.[32] In addition, "over one hundred countries have adopted the 'common reporting standard,' under which they agree to automatically share information regarding the bank and financial account holdings of other countries' residents, such as account numbers and account balances."[33]

Despite these legislative efforts to increase information reporting about offshore accounts, there are still significant information gaps. The gaps arise from: (1) some countries' decisions not to adopt the common reporting standard (foreign countries don't cooperate); (2) the IRS's inability to keep up with the volume of reporting under FATCA (even when there is data collection, the IRS can't keep up with it); (3) efforts by some taxpayers to hide their U.S. citizenship from their financial institutions (taxpayers evade the rules); (4) and banks' reluctance to investigate their customers' citizenship (banks don't cooperate).[34] Therefore, information reporting doesn't seem to work in this context.

Virtual currency transactions present similar problems. Beginning in 2024, digital asset brokers will be required to file information returns when their customers sell or exchange cryptocurrency, and individuals engaged in a trade or business will be required to self-report when they receive more than ten thousand dollars in digital assets (just as they do when they receive cash).[35] However, it is likely that many transactions will go unreported. First, exchanges may be made without a broker, and when there is no intermediary, the parties may not comply with reporting obligations.[36] In the case of exchanges of one virtual currency for another, both parties will have an incentive not to comply with reporting.[37] In other cases, the party responsible for information reporting may not have sufficient information about the other party to effectively report on the transaction.[38]

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30. *Id.*
31. *Id.* at 1619–20.
32. *Id.* at 1620.
33. *Id.* (quoting ORG. FOR ECON. CO-OPERATION & DEV., STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL ACCOUNT INFORMATION IN TAX MATTERS 10 (2014)).
34. *Id.* at 1621–22.
35. *Id.* at 1622.
36. *Id.* at 1622–23.
37. *Id.* at 1623.
38. *Id.*

Taxpayers also exploit holes in the information reporting regime to evade information reporting that would otherwise be required. For example, wholly-owned corporations can evade filing an IRS Form 1099-DIV by distributing "disguised dividends."[39] Disguised dividends are distributions that are, in substance, dividends that should be reported to the IRS.[40] Taxpayers disguise the distributions as loans or other types of non-dividend distributions that are not subject to information reporting.[41] Similarly, owners of wholly-owned corporations can use business entities "to manipulate the character of their income that is reported to the IRS" in order to underreport compensation income and avoid payroll taxes.[42] Together, these holes in the information reporting regime and evasion of the existing reporting requirements contribute to the size of the tax information gap.

### *B. The Proposal: Actor-Based Information Reporting*

The above examples reflected two significant problems with the information reporting regime: (1) the law does not require information reporting for all income-producing transactions; (2) and even when information reporting is required, there may be noncompliance with the information reporting rules. Blank and Glogower argue that both problems derive from the activity-based approach that underlies the information reporting regime.[43] In effect, they argue that even if it is theoretically possible to expand the information reporting regime to cover *all* taxable activities, the benefits would be uncertain, and such a regime would burden both compliant taxpayers and the IRS.[44] Meanwhile, experience with the existing information reporting regime suggests that even if all taxable transactions were subject to information reporting, noncompliance with the information reporting regime may persist, often for the benefit of higher income taxpayers.[45]

Therefore, rather than propose a patchwork of reforms to plug existing gaps—such as changes to the law that would require information reporting for significant activities that currently fall through the cracks, or by increasing enforcement of information reporting rules—they propose a more fundamental change to the information reporting regime itself. Namely, they make a case for an actor-based approach to information reporting that deemphasizes taxable activities, and instead requires "more general tax information reporting that would apply when taxpayers' income or wealth

39. *Id.* at 1624–25.

40. *Id.* at 1624.

41. *Id.* at 1624–25.

42. *Id.* at 1625–26.

43. *Id.* at 1616–17.

44. *See id.* at 1632 ("[T]his Part argues that this first- and third-party information reporting model, which would account for information on both actors and their activities, can also allow for more effective tailoring of penalties for noncompliance with information reporting rules and targeting of IRS audit resources.").

45. *See supra* Section I.A.2.

reaches a threshold amount."[46] Under their proposal, a financial institution may be required "to file information reports with the IRS regarding financial accounts of taxpayers whose taxable income or net wealth reaches threshold amounts."[47] For example, a high net worth taxpayer may "be subject to third-party reporting regarding inflows and outflows to their personal and business accounts at financial institutions."[48]

The proposed actor-based reporting regime would supplement, not replace, the existing information reporting rules.[49] Blank and Glogower argue that actor-based information reporting would have at least three benefits. First, it would enable the IRS to collect additional data about high-income and high net worth taxpayers, enabling the agency to "cast a wider net to capture the tax avoidance and tax evasion strategies that" they pursue.[50] Second, the supplemental rules "would be harder for high-end taxpayers to avoid."[51] Third, it "would reduce the inequity of current tax information reporting rules," which typically subject lower income taxpayers to more comprehensive and effective information reporting than high-end taxpayers.[52] These benefits would increase the effectiveness of the information reporting regime and make the tax system more equitable, assuming that policymakers can "determine how to execute actor-based adjustments to information reporting rules."[53]

Blank and Glogower's actor-based information reporting regime would adopt "a hybrid first- and third-party information reporting system" that leverages the advantages of both reporting models.[54] "Under [the] hybrid system, the first-party taxpayers would directly inform the third-party banks whether the taxpayer is subject to these heightened information reporting rules."[55] To demonstrate how this might work, the authors consider reforms to the Biden Administration's bank information reporting proposal. As proposed by the Biden Administration, "banks and other financial institutions would report to the IRS the amount of gross inflows (receipts) and outflows (transfers) of more than $600 (later revised to $10,000) from any business or personal account, including bank, loan, and investment accounts."[56]

Biden's proposed activity-based information reporting rules would cast a broad net that subjects all taxpayers to the same information reporting rules. This broad target would yield a tremendous amount of data—perhaps more

46. *Id.* at 1602.
47. *Id.* at 1604.
48. *Id.*
49. *Id.* at 1628.
50. *Id.* at 1629.
51. *Id.* at 1629–30.
52. *Id.* at 1630.
53. *Id.* at 1631.
54. *Id.* at 1646.
55. *Id.* at 1632.
56. *Id.* at 1600.

data than the IRS could hope to analyze—and bring a large number of taxpayers under the agency's gaze, but it is unclear whether it would substantially increase tax compliance.[57] For reasons like these, the Biden proposal has been criticized as unduly burdensome to taxpayers, and its implementation was placed on hold.[58] In contrast, an actor-based system

> could have only required this third-party bank flow reporting for taxpayers with income or assets equal to or exceeding specified thresholds. Financial institutions could collect this information directly from the account holders, who would in effect be required to certify whether they are subject to these heightened information reporting rules or not.[59]

In this way, the alternate system could "utilize[] taxpayer's first-person knowledge of their economic circumstances to only impose the heightened third-party information reporting rules when they are warranted."[60] The result would be a more targeted tax enforcement tool that is focused on a population of taxpayers who have traditionally eluded information reporting.

Blank and Glogower hope that changes like these would not only reduce the tax gap but would also lead to a more equitable tax system.[61] These are laudable goals and, given the history of tax evasion by high-income taxpayers and the continued limitations of the information reporting regime, they should be commended for thinking outside the box. The IRS has notoriously targeted their enforcement efforts at low-income taxpayers who claim refundable tax credits like the Earned Income Tax Credit,[62] and Blank and Glogower's proposal turns enforcement practices like those on their head by calling for more aggressive enforcement against wealthy taxpayers. For those who are concerned about tax equity and distributive justice, there is a lot to like about their proposal. Nevertheless, the next Part argues that these benefits should be weighed against potential privacy harms associated with expanded tax information collection.

## II. PRIVACY LOSS AND ACTOR-BASED INFORMATION REPORTING

The proposed actor-based approach to information reporting should be evaluated not only in terms of efficiency, equity, and simplicity, but also with respect to its privacy impact. This Part argues that the actor-based approach may violate the privacy interests of high-income taxpayers. Section II.A reviews

57. *Id.* at 1637–38.

58. *Id.* at 1637–40.

59. *Id.* at 1646.

60. *Id.* at 1647.

61. *Id.* at 1651 (concluding that a benefit of actor-based reporting is that it "would reduce the inequity of current tax information reporting rules).

62. *See* Alan Rappeport, *I.R.S. Changes Audit Practice That Discriminated Against Black Taxpayers*, N.Y. TIMES (Sept. 18, 2023), https://www.nytimes.com/2023/09/18/us/politics/irs-audits-black-taxpayers.html (on file with the *Iowa Law Review*).

the literature on tax privacy and the theory underlying a tax privacy objective. Section II.B analyzes the privacy implications of actor-based information reporting. It demonstrates that the proposal would create new privacy risks that are not implicated by the current regime.

### A. *Tax Privacy as a Policy Objective*

Blank and Glogower's actor-based information reporting proposal is one of several recent proposals to increase the amount of information collected from taxpayers based on—or about—taxpayer identity. For example, other scholars have proposed that the IRS collect data about taxpayers' racial identity, which could help researchers analyze the racial equity of tax law.[63] Other scholars (including the author of this Essay) have recommended that the IRS collect demographic data about participants in tax credit programs[64] and whistleblower programs.[65] Proposals like these are often motivated by concerns about structural inequality in the tax system and increasing economic inequality more broadly. For their part, Blank and Glogower are not merely concerned about the tax gap—they are concerned about the tax gap *at the top*. Information reporting gaps at the top of the income scale not only reduce tax revenues, but also decrease progressivity in the tax system and undermine vertical equity.

However, the potential equity gains associated with increased information collection may come at the price of reduced privacy. Professor Michael Hatfield has argued that privacy should constitute a tax policy norm alongside efficiency, equity, and administrability, and that "[t]ax scholars should measure the negative impact of specific tax provisions on privacy, weigh the impact against any benefits achieved, and propose ways to reduce the impact without undermining the benefits."[66] The harms associated with privacy loss may include "'unwelcome mental states,' such as anxiety, embarrassment, or unease," as well as external actions that reference private information, including "identity theft, gossip, or [] inappropriate government action based on data mining."[67] These harms may arise any time "information is observed, captured, disseminated, or used," including through "the tax-

63. *See generally* Jeremy Bearer-Friend, *Should the IRS Know Your Race? The Challenge of Colorblind Tax Data*, 73 TAX L. REV. 1 (2019) (explaining colorblindness and its relationship to historical tax data); DOROTHY A. BROWN, THE WHITENESS OF WEALTH: HOW THE TAX SYSTEM IMPOVERISHES BLACK AMERICANS—AND HOW WE CAN FIX IT 205 (2021) (arguing that federal tax policies perpetuate racial financial inequalities).

64. Michelle D. Layser & Andrew J. Greenlee, *Structural Inequality and the New Markets Tax Credit*, 73 DUKE L.J. 801, 868 (2024).

65. Karie Davis-Nozemack & Sarah J. Webber, *Lost Opportunities: The Underuse of Tax Whistleblowers*, 67 ADMIN. L REV. 321, 364 (2015).

66. Hatfield, *supra* note 13, at 583.

67. *Id.* at 594–95 (quoting M. Ryan Calo, *The Boundaries of Privacy Harm*, 86 IND. L.J. 1131, 1133 (2011)).

filing process, the tax enforcement process, and the process of securing taxpayer information."[68]

Though few studies have examined the privacy issues raised by third-party information reporting procedures, scholars have analyzed the privacy issues raised by information collection more generally. The IRS's authority to collect information is expansive, extending "to any information potentially relevant to determining any tax liability."[69] For this reason, Hatfield has argued that "privacy interests ought to constrain the IRS's collection of information" because taxpayers "have an interest in how much of their information is collected by the government."[70] But what exactly *is* that interest? Professor Adam Thimmesch has identified three theories that may help define tax privacy interests and to determine whether they have been violated. He describes these theories as "(1) a broad, neutral approach; (2) a normative approach; and (3) a context-dependent approach."[71]

The broad, neutral approach "evaluates privacy independent of any normative judgment."[72] Under this theory, privacy is "viewed as total isolation," whereby no information is shared with others, and any departure from that absolute ideal constitutes a loss of privacy.[73] In addition to setting an impossible standard, this theory "tells us very little about how to make policy because it does not consider how to balance privacy interests against other interests."[74] At the other extreme, the normative approach "requires a comparison of the relative values of privacy and whatever other end is being sought," but it also "requires immense personal judgment."[75] To overcome this limitation, theorists adopting the normative approach sometimes look to people's consent to disclosure to determine whether their privacy has been violated. Since "we consent to being monitored all of the time" through our use of technology like search engines and smart devices, some scholars have argued that "privacy is dead."[76]

However, Thimmesch argues it is unlikely "that taxpayers purposefully balance their interests before they allow [] information [to] flow,"[77] so consent is an imperfect touchstone.

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68. Adam B. Thimmesch, *Tax Privacy?*, 90 TEMP. L. REV. 375, 382 (2018).

69. Hatfield, *supra* note 13, at 596; *see also* I.R.C. § 7602(a)(1) (authorizing the Secretary "[t]o examine any books, papers, records, or other data which may be relevant or material to such inquiry").

70. Hatfield, *supra* note 13, at 606, 609.

71. Thimmesch, *supra* note 68, at 379.

72. *Id.*

73. *Id.* at 398.

74. *Id.*

75. *Id.* at 399.

76. *Id.* at 401–02 (quoting David Alan Sklansky, *Too Much Information: How Not to Think About Privacy and the Fourth Amendment*, 102 CALIF. L. REV. 1069, 1085 (2014)).

77. *Id.* at 405.

The third theory, the context-dependent approach, looks to contextual norms to understand when privacy has been violated. The theory is based on the idea that people are often inconsistent about when and how they protect private information.[78] A taxpayer "might keep financial information private from a new acquaintance . . . but . . . readily share that information with our spouse or with our accountant."[79] For this reason, the context-dependent approach adopts a pragmatic definition of privacy that evaluates privacy "against prevailing informational norms in a given context."[80] Under this theory, taxpayers may experience privacy harms if information collection practices violate "the existing norms related to information flows" in the context of taxation.[81]

However, Thimmesch argues that the existing norms about tax privacy are strikingly permissive. He explains, "[t]ax is a context in which the norms of information flows have developed to be incredibly lax."[82] Taxpayers regularly disclose both financial and nonfinancial personal information to the IRS. They provide this information—or signal its existence—when they claim exclusions, deductions, and credits. The IRS routinely collects information about taxpayers' "medical expenses, religious affiliations, and information regarding where her children sleep, play, or are cared for . . . whether she has moved, her educational expenses, and how she has funded her home purchases."[83] Some of this information is revealed on taxpayers' tax returns, while other information is collected via audit.

Hatfield surmised "that very few of those who file one of the 145,000,000 individual income tax returns . . . understand how many personal details may come within the IRS's grasp."[84] Yet, despite this invasiveness—and despite taxpayers' general distrust of the IRS—tax collection procedures have rarely been challenged on privacy grounds.[85] Thimmesch argues "that the lack of any real privacy challenges to our tax system is a function of a stable system that protects existing informational norms," which essentially "reduce tax privacy to something close to tax confidentiality."[86] At least initially, this theory of tax privacy suggests that tax information collection will rarely violate taxpayers' privacy expectations as long as the data is kept confidential. However, as the next section will explain, actor-based information reporting may present privacy concerns despite this permissive context.

78. *Id.* at 402.
79. *Id.*
80. *Id.* at 403.
81. *Id.*
82. *Id.*
83. *Id.* at 383.
84. Hatfield, *supra* note 13, at 580–81.
85. Thimmesch, *supra* note 68, at 404.
86. *Id.*

### *B. Privacy Analysis of Actor-Based Information Reporting*

The theories described above help shed light on the privacy interests implicated by actor-based information reporting. First, the neutral approach makes it clear that any information flows from taxpayers (or third parties) to the IRS reflect a privacy loss of some sort. That theory does not explain when privacy loss constitutes an invasion, but by drawing attention to privacy loss, it invites a conversation about when privacy loss might be harmful. Privacy loss through information collection has become pervasive in everyday life—from web cookies,[87] to social media,[88] to Siri and Alexa,[89] to DNA genetic testing.[90] Though many people are either comfortable with or resigned to giving their data to private companies,[91] these technologies have spurred public debates about privacy and cybersecurity.[92] In the tax context, the amount of data collected by the IRS has also increased over time,[93] with far less public outcry.[94] Nevertheless, it is essential to ask whether the privacy loss caused by IRS information collection procedures might be harmful. This Section considers the possible privacy risks associated with a move toward actor-based information reporting.

#### 1. Consent and Third-Party Information Reporting

Though imperfect, the normative theory provides some insight into privacy risks associated with actor-based information reporting. To reiterate, to overcome the challenges associated with personal judgments about privacy, normative theories often look to the absence of consent as evidence of a

87. Emily Stewart, *Why Every Website Wants You to Accept Its Cookies*, VOX (Dec. 10, 2019, 8:00 AM), https://www.vox.com/recode/2019/12/10/18656519/what-are-cookies-website-tracking-gdpr-privacy [https://perma.cc/NVU3-Y84M].

88. Vittoria Elliott, *The New Era of Social Media Looks as Bad for Privacy as the Last One*, WIRED (Nov. 1, 2023, 5:00 PM), https://www.wired.com/story/x-alternatives-user-privacy-report (on file with the *Iowa Law Review*).

89. Rozita Dara, *The Dark Side of Alexa, Siri and Other Personal Digital Assistants*, THE CONVERSATION (Dec. 15, 2019, 8:34 AM), http://theconversation.com/the-dark-side-of-alexa-siri-and-other-personal-digital-assistants-126277 [https://perma.cc/G4KR-RK9S].

90. Lesley Fair, *Privacy and Security of Genetic Information: Putting DNA Companies to the Test*, FTC BUS. BLOG (June 16, 2023), https://www.ftc.gov/business-guidance/blog/2023/06/privacy-security-genetic-information-putting-dna-companies-test [https://perma.cc/XTV4-4SY8].

91. Meiling Fong & Zeynep Arsel, *Protecting Privacy Online Begins with Tackling 'Digital Resignation,'* THE CONVERSATION (Mar. 2, 2023, 2:38 PM), http://theconversation.com/protecting-privacy-online-begins-with-tackling-digital-resignation-198979 [https://perma.cc/X3GD-TNRL].

92. *See, e.g.*, Cameron F. Kerry, *The Privacy Debate*, BROOKINGS INST. (July 7, 2023), https://www.brookings.edu/projects/the-privacy-debate [https://perma.cc/KZ8L-23HL] (creating a platform to publish content by "thought leaders on privacy, information security, and the digital economy to inform the growing national debate about individual privacy").

93. Michael Hatfield, *Cybersecurity and Tax Reform*, 93 IND. L.J. 1161, 1166 (2018) (noting "the increasing use of information technology (IT) at the IRS to collect more personal information").

94. Thimmesch, *supra* note 68, at 410 ("The growth in the Tax Code is notable, but has been incremental and without an appreciable pause to analyze the privacy implications of the system that has emerged.").

privacy violation.[95] By this standard, mandatory information reporting violates taxpayer privacy. To understand why, it is helpful to contrast mandatory information reporting to another information collection context: tax preference claimants. When taxpayers voluntarily claim deductions, credits, and exemptions, one might argue that they implicitly consent to certain personal data disclosures and potentially invasive audits. For example, a taxpayer who does not wish to disclose her medical condition to the IRS can simply refrain from claiming a deduction for medical expenses. The act of claiming the deduction, which is voluntary, may be taken as an expression of consent. If she consented to disclosure, then subsequent requests for medical records by the IRS are not invasive—in theory.

Numerous scholars have challenged this analysis. They point out that taxpayers may not be aware of the IRS's authority to collect information, or they may not realize that claiming a deduction makes them vulnerable to invasive audits.[96] Even if taxpayers *are* aware of the risks and are willing to give up privacy as a cost of claiming deductions, the consent may still be coerced: the only way to avoid privacy loss is to voluntarily pay more taxes than are legally required.[97] In other words, even in the best-case scenario—in which taxpayers make a voluntary statement to the IRS that implicitly conveys consent—there are good reasons to question whether that consent is valid.

In the context of actor-based information reporting, the case for finding taxpayer consent is even less persuasive. In fact, it is nearly impossible to point to any voluntary act by the taxpayer that could be construed as consent to the actor-based information reporting regime. First, information reporting is never voluntary in the same way that claiming a deduction is voluntary. Parties who engage in certain activities are legally obligated to participate in information reporting,[98] whereas no taxpayer is legally obligated to claim a deduction. This alone makes consent less likely to be present. Second, even if we assume that taxpayers implicitly consent to activity-based information reporting by participating in transactions, that rationale would not apply in the context of actor-based information reporting.

To see why, first consider the fact that the actor-based information reporting proposal is at least partially motivated by an observation that activity-based information reporting is too easily avoided. From a privacy perspective, the capacity for taxpayers to avoid transactions that would expose them to information reporting is critical: it makes it plausible to argue that taxpayers who choose to participate in those transactions have consented to information reporting. A shift to an actor-based information reporting regime would foreclose the argument that the taxpayer implicitly consented to information reporting by voluntarily participating in transactions. Compliance

95. *See supra* notes 76–77 and accompanying text.

96. Hatfield, *supra* note 13, at 580–81; Thimmesch, *supra* note 68, at 405–07.

97. Hayes Holderness, *Taxing Privacy*, 21 GEO. J. ON POVERTY L. & POL'Y 1, 2 (2013).

98. I.R.C. §§ 6721–6723 (describing penalties for failure to comply with certain information reporting requirements).

with information reporting would become purely compulsory for those who meet the actor-based criteria. That absence of consent may reflect a privacy invasion not implicated by the current activity-based information reporting regime.

Thus, consent-based arguments in support of actor-based information reporting are likely to fail. However, consent is not the only standard potentially relevant to evaluate taxpayer privacy. As discussed above, the context-dependent approach provides a separate, context-specific set of norms for tax privacy.[99] The next Section argues that actor-based information reporting departs from those norms in ways that may threaten taxpayers' privacy interests.

### 2. Departure from the Status Quo

Actor-based information reporting may depart from norms in ways that violate the privacy expectations of taxpayers, thereby introducing privacy harms under a context-dependent theory of tax privacy. This is because actor-based information reporting would be a significant departure from the status quo. The regime was proposed as a distinct approach to supplement the traditional activity-based approach to information reporting.[100]

The current activity-based regime applies to all taxpayers, regardless of income level, and focuses on collecting information about transactions.[101] In contrast, the proposed actor-based information reporting would apply only to high-income and high net worth taxpayers, and it would require at least some disclosures and reporting about assets or cash flows even when there are no triggering transactions.[102] Actor-based information reporting, therefore, would differ from established information reporting procedures. The question is whether these changes are significant enough to violate the permissive privacy norms associated with taxation.

The answer is yes. For reasons to be explained, the traditional activity-based information reporting regime corresponds to realization events that expose taxpayers to income taxation, including various reporting obligations. Actor-based information reporting would not be tied to realization, and it would force taxpayers to disclose information they may not perceive as relevant to income taxation. Here, some background may be helpful. Realization generally refers to "some act of separation or conversion of property into cash or other property."[103] For example, if a taxpayer owns stock that increases in value, then his increase in wealth may constitute income from an economic perspective, but it will *not* be considered taxable income until there has been a realization event. However, when and if the taxpayer *sells* the

99. *See supra* notes 80–83 and accompanying text.

100. Blank & Glogower, *supra* note 5, at 1628.

101. *Id.*

102. *Id.*

103. John R. Brooks & David Gamage, Moore v. United States and the Original Meaning of Income 3 (July 2, 2023) (unpublished manuscript) (on file with author).

stock, then the sale will be a realization event that triggers an income tax on the appreciated value.[104] Because realization is almost always a prerequisite to income taxation, the income tax can be understood as an activity-based tax.[105]

The current activity-based information reporting regime captures activities that trigger realization events: compensation payments, asset sales, distributions of dividends and interest payments, and so forth. Blank and Glogower have demonstrated that many transactions lie outside the information reporting regime, allowing important realization events to transpire beyond the gaze of the IRS.[106] Lawmakers could expand the information reporting regime to include more realization events. Such expansion may raise questions about how much data the IRS should collect from taxpayers, but it would not present novel privacy issues related to the *type* of information. This is because taxpayers are legally required to report all realization events to the IRS, so information reporting would not reveal information that the taxpayer could have legally kept private. In addition, the permissive tax privacy norms described above are grounded in the activity-based regime, and most taxpayers routinely disclose information about realization events to the IRS.

In contrast, actor-based information reporting would present novel privacy issues related to the type of information collected. This is because the regime would force taxpayers to disclose some information that may be *unrelated* to the realization events that are subject to income taxation. For example, taxpayers may be required to report on the location or value of assets, even if they are not associated with any realized income. Recall that merely holding assets—even a lot of very valuable assets—does not create

104. *See* 26 U.S.C. §§ 61(a)(3), 1001 (2024).

105. *See* Cottage Savings Ass'n v. Comm'r, 499 U.S. 554, 661–62 (1991). At the time of writing, the realization requirement was at the center of a closely watched Supreme Court case called *Moore v. United States.* Moore v. United States, 36 F.4th 930 (9th Cir. 2022), *cert. granted*, (2023) (No. 22-800). In *Moore* the taxpayers have challenged an obscure provision of the Tax Cuts and Jobs Act that taxed undistributed earnings of controlled foreign corporations *as if* the earnings had been distributed to shareholders. Brooks and Gamage, *supra* note 103, at 6. The taxpayers have argued that the so-called repatriation tax is unconstitutional under the Sixteenth Amendment. *Id.* at 2. According to the taxpayers, the Sixteenth Amendment only authorizes taxation of realized income, and the repatriation tax reaches unrealized income. *Id.* at 2–3. Prior to *Moore*, many tax scholars believed that realization is not constitutionally required, but it is merely a pragmatic policy choice that is reflected by the tax statutes and is intended to ease administration. John R. Brooks & David Gamage, *Taxation and the Constitution, Reconsidered*, 76 TAX L. REV. 75, 130–32 (2022); Henry Ordower, *Revisiting Realization: Accretion Taxation, the Constitution, Macomber, and Mark to Market*, 13 VA. TAX REV. 1, 3, 7 (1993). Constitutionally required or not, most income tax laws are limited to realized income. *See* Patricia D. White, *Realization, Recognition, Reconciliation, Rationality and the Structure of the Federal Income Tax System*, 88 MICH. L. REV. 2034, 2044 (1990) ("Simply put, our system generally regards the realization of a potentially taxable amount as the occasion for its recognition.") (citation omitted); Alex Zhang, *Rethinking* Eisner v. Macomber, *and the Future of Structural Tax Reform*, 92 GEO. WASH. L. REV. 179, 184–85 (2024) (referring to "the realization requirement" and noting that the traditional view among experts is that the "requirement is now based on legislative judgment rather than constitutional mandate").

106. *See supra* Section I.A.1.

income tax obligations under current law.[107] Since substantive income tax law does not reach these assets, taxpayers can choose to keep information about such asset holdings private. An actor-based reporting regime that requires asset disclosures would force taxpayers to reveal information they could have otherwise kept private under substantive tax law. This would be a significant change to the procedures taxpayers have grown comfortable with (or resigned to) from a privacy standpoint.

For these reasons, the loose tax privacy standards set by the status quo may not apply to actor-based information reporting. Taxpayers have low expectations for privacy in the tax context,[108] but their privacy expectations may be higher with respect to information that would not typically be shared in connection with an income tax. Moreover, the proposed actor-based reporting regime would require taxpayers to share information about themselves with nongovernment *third parties*.[109] The permissive tax privacy norms apply in the context of information flows between taxpayers and the IRS, but they may not extend to tax laws that require taxpayers to disclose private information to third parties. Many people prefer to keep their financial information, such as income level or wealth, private from others, even if they are willing to share that information with the government. In the context of information reporting, it is one thing to require third parties to share information about the taxpayer (subject to the discussion above), but quite another to require the taxpayer to share information about themselves to third parties. Yet, the proposed actor-based reporting regime would require taxpayers "to certify to third parties if they have income or assets equal to or exceeding the threshold amounts, and are therefore subject to the third-party information rules."[110]

In sum, there are at least two reasons why the traditionally permissive tax privacy norms may not apply to actor-based information reporting. First, the type of information collected would be qualitatively different from what taxpayers expect to be within the reach of the IRS. The permissive tax privacy norms are built around disclosure of realization events, whereas the proposed regime could require disclosure of unrealized income that is not taxed under current law. Second, actor-based information reporting would require disclosures that go beyond the context of reports to the government. It would require taxpayers to disclose private financial information about themselves to third parties. The permissive tax privacy standards applicable to taxpayer-to-IRS information flows may not apply in this new context.

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107. *See supra* notes 104–05 and accompanying text.

108. *See supra* notes 84–94 and accompanying text for a discussion of how the tax context relates to privacy expectations.

109. *See* Blank & Glogower, *supra* note 5, at 1646 ("Taxpayers would then be required to report, or certify to third parties if they have income or assets equal to or exceeding the threshold amounts . . . .").

110. *Id.*

### 3. Cybersecurity as an Emerging Tax Privacy Risk

Before moving on, it is worth noting that the context-specific theories of privacy rest on an assumption that the status quo preserves a normatively desirable level of privacy.[111] If this premise is false, then actor-based information reporting may present privacy harms *even if* one concluded that it is not meaningfully different from prior practices. Thimmesch points out that "American taxpayers might have low expectations of tax privacy simply because they have never been afforded an alternative option."[112] Meanwhile the tax law and its corresponding information collection regime has already grown incrementally over time. One might question whether the status quo, with its loose standards for privacy, should continue to guide policies about information collection in the future, particularly as cybersecurity threats increase.

The risk of IRS data breaches may call for higher privacy standards than taxpayers have demanded in the past. Hatfield has analyzed cybersecurity threats to the IRS, noting first that "the IRS information system is the 'gold standard' for cyberattacks in the United States."[113] He argues that the IRS will fail to implement effective cybersecurity because the agency has inadequate funding,[114] insufficient expertise,[115] and too many users[116]—and because cybersecurity at this scale is simply too difficult. Noting a growing list of government data breaches and numerous private sectors breaches, he concludes: "[t]here is [simply] no reason to believe that the IRS will be able to succeed where so many agencies and corporations have failed, especially given that the treasure trove of information that the IRS likely will be storing in the future is far more valuable information than credit card numbers."[117]

For this reason, Hatfield proposes tax reforms that would radically reduce the amount of taxpayer information handled by the IRS. Specifically, Hatfield favors reforms to increase cybersecurity "by tasking the IRS with collecting less information, collecting information on fewer individuals, and

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111. Thimmesch, *supra* note 68, at 410.

112. *Id.* at 410–11.

113. Hatfield, *supra* note 93, at 1163 (quoting Krysia Lenzo, *Ex-FBI Official: IRS Is a Favorite Target*, CNBC (Feb. 10, 2016, 4:27 PM), http://www.cnbc.com/2016/02/10/ex-fbi-official-irs-is-a-favorite-hacking-target.html [https://perma.cc/84ER-DJKD].

114. Hatfield, *supra* note 93, at 1184–85. Hatfield notes that "after four years of work and $139 million dollars, the IRS has failed even to upgrade from Windows 2003 to Windows XP." *Id.* at 1164. Despite significant spending on information technology systems, the agency still "suffers the greatest IT backlog of all federal agencies" and "it is most unlikely that it will be able to meet its cybersecurity needs without an extraordinary increase in funding specifically for the task." *Id.* at 1185.

115. *Id.* at 1185–86 (noting the IRS has been unable to compete with the private sector for cybersecurity talent).

116. *Id.* at 1187 (arguing employees themselves constitute a security threat because they may intentionally misappropriate information, negligently mishandle information, or otherwise fail to guard against cyberattacks like phishing and malware).

117. *Id.* at 1189.

issuing fewer refunds."[118] In one sense, actor-based information is consistent with these goals; the approach would target the subset of taxpayers most relevant to close the tax gap at the top, helping to minimize the number of taxpayers subject to the enhanced information reporting regime. However, actor-based information reporting would also expand the amount of information collected from high-income taxpayers, thereby increasing the amount—and type—of information vulnerable to cyberattack. The privacy interests of the wealthy are sometimes downplayed in the literature, but this is a risky move.[119] Relaxing privacy norms for the wealthy is only a short step toward relaxing the norms for other, more vulnerable, groups of taxpayers.

To summarize, this Part has argued that actor-based information reporting may present greater privacy risks than the current activity-based information reporting regime. This does not mean that Blank and Glogower's proposal should be rejected. Rather, the goal of this Part has been to surface the privacy issues that policymakers should consider when evaluating the proposal. It may well be that the equity and efficiency benefits of actor-based reporting outweigh any privacy harms. To be sure, it is rare for any law to advance every tax policy objective; there are nearly always going to be trade-offs among efficiency, equity, and simplicity. The goal of this Part was simply to suggest that privacy objectives should be added to the list, and to demonstrate how they might apply to actor-based information reporting. The next Part considers an alternative approach to close the tax information gap at the top that may present fewer privacy risks than actor-based information reporting.

## III. A LESS INVASIVE ALTERNATIVE: THE INCENTIVE-BASED APPROACH

The activity-based information reporting regime has failed to close the tax information gap at the top. Apart from the focus on activities, shortcomings under the current regime can be attributed to two problems: (1) holes in the information reporting regime itself, whereby certain significant transactions simply are not captured; (2) and parties' deliberate non-compliance with existing information reporting rules. These problems could be addressed by shifting toward an actor-based information reporting regime that is more comprehensive and more difficult to evade, but doing so would introduce new privacy risks not presented by current law. The purpose of this Section is to consider an alternative, less radical approach that may present fewer privacy concerns.

Namely, this Section considers how economic incentives can be leveraged to help close the tax information gap in certain key areas. The discussion above has surfaced several insights that may help develop and evaluate incentives for information reporting. The first insight, which is based in the tax privacy literature, is that taxpayers are often willing to share sensitive

118. *Id.* at 1190.

119. Hatfield, *supra* note 13, at 608–09 (noting some scholarship "tends toward[] being radically anti-privacy, at least with respect to the wealthy").

information about themselves to claim tax preferences.[120] As discussed above, the sharing of personal information—or information unrelated to actual income events—may create significant privacy risks. However, incentives to provide information may be acceptable if they are designed (1) to collect *financial* information related to actual realization events; and (2) to minimize collateral collection of private personal information. Section III.A will explore how proposed Renter's Tax Credits could potentially meet these objectives.

The second insight, highlighted by Blank and Glogower, is that third party information reporting is often effective when taxpayers share information to parties with reporting obligations. If taxpayers are *forced* to share information with third parties with reporting obligations, the law may present privacy concerns. However, if taxpayers can be nudged to *voluntarily* share more information with third parties who have reporting obligations, then the IRS could take advantage of third-party information reporting with less privacy risk. Section III.B will draw on research by Professor Heather Field to explain how incentives could be used to encourage taxpayers to buy tax insurance from providers with information reporting requirements. If successful, such incentives could increase the salience transactions with uncertain tax positions.

A third insight, surfaced by Blank and Glogower, is that some parties with information reporting obligations will evade reporting requirements at the urging of their clients. This is a serious challenge for any information reporting regime. While it may be possible to create economic incentives for these parties that outweigh market incentives that favor noncompliance, a simpler approach may be to strengthen incentives and protections for another group: whistleblowers. As discussed in Section III.C below, whistleblower laws are already used to some degree of success, and strengthening whistleblower incentives may be a useful addition to the information reporting regime.

To be sure, any proposal to close the tax information gap through increased data collection carries the risk of privacy violations due to the cybersecurity risks described in Section II.B above. Nevertheless, increased data collection may be necessary to ensure that the tax system is equitable and efficient. In such case, incentives like those described below may help shrink the tax information gap at the top, while also minimizing privacy harms.

### A. *Renter's Tax Credits*

A significant gap in the current information reporting regime relates to underreported rental income.[121] Rental income is not subject to information reporting, and it would be difficult to require information reporting in this context as it would be extremely burdensome for tenants to file information reports. For the most part, tenants are not sophisticated taxpayers, and it is

120. *See supra* Section II.A for a discussion of tax privacy norms.

121. *See supra* text accompanying notes 18–19.

unlikely that many are familiar with information reporting procedures. This presents a challenge for tax enforcement, since the IRS must rely entirely on landlords to report the rent payments they received, and landlords may underreport those figures. Ideally, the IRS would have some ability to collect data about the amount of rent that was *paid* by tenants to help detect tax evasion by landlords. Enter: renters' tax credits ("RTC"s).

Federal RTCs do not exist under current law, but proposals to enact an RTC are gaining traction in Washington and policy circles.[122] Supporters argue that RTCs would help promote equity and alleviate rent burdens and housing insecurity among tenants.[123] Depending on the design, the tax credits may reimburse tenants for a percentage of rent paid to landlords,[124] or they may reimburse landlords for discounted rates they provide to tenants.[125] In either case, the tenant would receive a benefit in the form of a rent supplement. And, in either case, either the tenant or the landlord would need to report to the IRS the amount of rent paid.

For this reason, a collateral benefit of an RTC is that it could provide an incentive for taxpayers to share information to the IRS about rental payments. If the tax credit is structured as a landlord-side tax credit, then the landlord would have an incentive to self-report rent collections to claim the tax credits. Any privacy risks posed by the tax credit should be the same as under current law; landlords are already legally obligated to report rents. The larger issue presented by landlord-side RTCs relates to their reach: most proposals for landlord-side RTCs provide for capped tax credits that would be available to a subset of taxpayers.[126] If only a small number of landlords are eligible to participate, the information gains may be minimal.

Tenant-side RTCs, on the other hand, could be designed to reach many tenants. For example, a tenant-side RTC proposed by Senator Cory Booker would be available to all tenants, subject to rent limits.[127] Tenants would report their rents to the IRS to claim a tax credit that reimburses them for a portion of their rent payments.[128] There is some privacy loss associated with this tax reporting, particularly for low-income tenants who are not required

122. *See, e.g.*, Rent Relief Act of 2018, S. 3250, 115th Cong. (2018) (Harris Proposal); Rent Relief Act of 2019, S. 1106, 116th Cong. (2019) (Harris Proposal); Housing, Opportunity, Mobility, and Equity Act of 2018, S. 3342, 115th Cong. (2018) (Booker Proposal); Rent Relief Act of 2019, H.R. 2169, 116th Cong. (2019) (Davis Proposal); Housing, Opportunity, Mobility, and Equity Act of 2019, H.R. 4808, 116th Cong. (2019) (Clyburn Proposal); Renters Tax Credit Act of 2021, S. 2554, 117th Cong. (2021) (Brown Proposal); Decent, Affordable, Safe Housing for All Act (DASH Act), S. 680., 118th Cong. (2023) (Wyden Proposal).

123. Will Fischer, *Renters' Tax Credit Would Reduce Housing Cost Burdens*, CTR. ON BUDGET & POL'Y PRIORITIES (Nov. 3, 2016, 1:00 PM), https://www.cbpp.org/blog/renters-tax-credit-would-reduce-housing-cost-burdens [https://perma.cc/9PLB-TMZD].

124. *See, e.g.*, S. 3250, 115th Cong. (2018); S. 1106, 116th Cong. (2019); S. 3342, 115th Cong. (2018).

125. S. 680., 118th Cong. (2023).

126. *See, e.g.*, *id.*

127. S. 3342, 115th Cong. (2018).

128. *Id.*

to file tax returns. However, it is notable that many low-income tenants already file tax returns to claim the earned income tax credit ("EITC").[129] Many tenants already report information about their income, address, and family information to claim the EITC, [130] and it is unlikely that the RTC would require many other disclosures apart from the amount of rent paid.[131]

A broad-reaching RTC like the one proposed by Booker would be very expensive, [132] but it is conceivable that some of the cost could be offset by increased tax collections if the RTC helps detect tax evasion by landlords. To realize this potential, it would be necessary to include some mechanism to match tenants with their landlords. A law could require all landlords to provide tenants with a unique Landlord Taxpayer Identification Number ("L-TIN") analogous to an Employer Identification Number ("EIN").[133] Tenants could be required to include their landlords' L-TIN on their tax return, and the IRS could compare numbers reported by tenants with landlords. When significant disparities are detected—a matching error—the IRS could initiate an audit.[134]

That said, a significant risk of matching landlord and tenant data is that the IRS may focus its enforcement efforts on tenants rather than landlords. Most RTCs would be structured as refundable tax credits. Refundable tax credits provide taxpayers with cash transfers to the extent that their tax liability is too low to absorb the full credit.[135] Experience with another major refundable tax credit, the EITC, suggests that the IRS devotes significant enforcement resources to preventing fraudulent tax credit claims.[136] In the

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129. I.R.C. § 32 (2024). *See EITC Participation Rate by States Tax Years 2013 Through 2020*, I.R.S. (Jan. 26, 2024), https://www.eitc.irs.gov/eitc-central/participation-rate-by-state/eitc-participation-rate-by-states [https://perma.cc/V9A9-LSCG] (reporting a 76.3 percent national participation rate for the 2020 tax year). For a discussion of the privacy concerns raised by the EITC and similar programs, see generally Holderness, *supra* note 97.

130. *See* Francine J. Lipman, *Access to Tax InJustice*, 40 PEPP. L. REV. 1173, 1185, 1187–88 (2013) (discussing tax filing by EITC claimants). Under the law, the amount of EITC is calculated based on taxpayer's income level and number of children. *See* I.R.C. § 32. Therefore, claiming an EITC would necessarily convey this information. Taxpayers include their home addresses on their income tax returns. *See* I.R.S., DEP'T OF THE TREASURY, FORM 1040 (2023).

131. As discussed above, an RTC would be calculated based on taxpayers' income and rent paid, subject to rental limits that may reference the local area rents. *See, e.g.*, Housing, Opportunity, Mobility, and Equity Act of 2018, S. 3342, 115th Cong. (2018). Therefore, claiming an EITC would likely entail disclosures of taxpayers' income level, address, and rent paid.

132. PEGGY BAILEY, NAT'L LOW INCOME HOUS. COAL., RENTAL HOUSING PROGRAMS FOR THE LOWEST-INCOME HOUSEHOLDS: RENTERS' TAX CREDIT 109 (2023) (estimating that an entitlement RTC like that proposed by Booker would "cost . . . $76 billion per year").

133. *Employer ID Numbers*, I.R.S. (Mar. 4, 2024), https://www.irs.gov/businesses/small-businesses-self-employed/employer-id-numbers [https://perma.cc/W98Y-MMNC].

134. *See* Edward A. Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the "Tax Gap,"* 24 AKRON TAX J. 1, 7 (2009). The IRS uses document matching programs to "correlate information reporting to amounts reported on taxpayer returns" to detect noncompliance. *Id.*

135. Susannah Camic Tahk, *The Tax War on Poverty*, 56 ARIZ. L. REV. 791, 799 (2014).

136. *See* Rappeport, *supra* note 62.

event of a matching error between landlords and tenants, it is possible that the IRS would suspect that tenants—not landlords—are the more likely tax cheats. This means that landlord tax evasion could increase *tenants'* risk of audits, along with related privacy invasions. In that case, both equity and privacy considerations may counsel against using an RTC as an incentive for information reporting.

Nevertheless, the RTC example demonstrates how tax incentives can be used to help close the tax information gap at the top. The traditional information reporting regime is hard to apply to the landlord-tenant context, but incentives like an RTC could achieve the same goal of providing the IRS with a more complete picture of payments made to landlords. If the risks of unequal enforcement can be addressed, an RTC could dramatically improve the IRS's ability to detect tax evasion among landlords. It would do so by creating incentives for landlords or tenants to share information about rent transactions with the government. The next Section will provide an example of how incentives can be used to encourage taxpayers to share relevant information with third parties in ways that aid enforcement efforts.

### *B. Tax Insurance*

In some cases, it may be challenging to create incentives for taxpayers to share information with the IRS, but it may nevertheless be possible to nudge them to share information with third parties with reporting obligations. Professor Heather Field has proposed an enforcement regime that uses incentives to encourage taxpayers to purchase tax insurance.[137] Tax insurance is typically purchased by high-end taxpayers and businesses that engage in transactions involving tax risk.[138] For example, parties to a tax-free merger may purchase tax insurance to mitigate the risk that the transaction may turn out to be taxable.[139] Under Field's proposal, both taxpayers and tax insurers would be required to disclose that tax insurance was obtained.[140] Taxpayers would also be required "to explain the uncertain issue, state the magnitude of the expected tax benefit if the position is sustained, and provide basic information about the policy details."[141] Meanwhile, "[e]ach tax insurer would have to provide the IRS with a list of tax insurance policies the insurer bound during the taxable year, identifying the insured taxpayer and insured position."[142]

To encourage taxpayers to voluntarily purchase tax insurance—and to opt into this information reporting regime—Field proposes several

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137. *See generally* Heather M. Field, *Tax Enforcement by the Private Sector: Deputizing Tax Insurers*, 99 IND. L.J. (forthcoming 2024) (arguing the IRS should utilize tax insurers as an enforcement mechanism) (on file with the author).

138. *Id.* (manuscript at 7–8) (on file with the author).

139. *Id.* (manuscript at 9) (on file with the author).

140. *Id.* (manuscript at 43) (on file with the author).

141. *Id.* (manuscript at 38) (on file with the author).

142. *Id.*

incentives. First, the IRS would recognize certain insurers as "qualified insurers," and it would treat positions insured by them as "likely compliant."[143] Benefits of obtaining insurance from a qualified insurer may include:

> a lower likelihood of audit, access to an expedited ruling process for the position (if the taxpayer requests), an expedited audit process (if the position is audited), a cooperative regulatory interaction more generally, and tax credits for insurers and taxpayers (e.g., to cover audit costs when an insured position is sustained on audit or merely to entice participation in the regime).[144]

Benefits like these would create incentives for taxpayers to participate in the enforcement regime, including both self- and third-party information reporting. Since taxpayers are willing to share detailed and accurate information with their insurance providers, third-party disclosures about these transactions can help close the tax information gap at the top.

From a privacy perspective, Field's proposal has several benefits. First, taxpayers would voluntarily opt into the information reporting regime by purchasing tax insurance. The disclosure obligations would be a salient feature of tax insurance transactions, and taxpayers who wish to avoid disclosures can simply refrain from purchasing a policy. In this way, taxpayers would consent to the information reporting regime, thereby reducing the likelihood of privacy harms. Second, taxpayers obtain insurance for tax positions related to transactions that may (or may not) be taxable under income tax laws. The required disclosures would relate to activities that are potentially taxable, just like other types of information collected under the activity-based information reporting regime. This suggests that the disclosures are aligned with the permissive tax privacy norms described in Section III.A above.

### *C. Whistleblower Incentives*

The incentives above would encourage parties to share information about transactions, but incentives can also be used to encourage parties to share information about instances of noncompliance. An existing incentive program that can help detect noncompliance—including when taxpayers evade reporting requirements—is the tax whistleblower program. The IRS Whistleblower Office administers both discretionary and mandatory awards to informants that help the IRS detect tax evasion.[145] According to the

143. *Id.* (manuscript at 43–44) (on file with the author).

144. *Id.*

145. The first are discretionary awards. Under I.R.C. § 7623(a) (2024), the IRS "is authorized to pay such sums as he deems necessary for [] detecting underpayments of tax, or [] detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws." The second are mandatory awards for large whistleblower claims. Under I.R.C. § 7623(b), a whistleblower who makes a substantial contribution to the tax enforcement effort may receive between fifteen and thirty percent of the amounts recovered by the IRS. However, the I.R.C. § 7623(b) awards are only available if the targeted taxpayer's gross income exceeds $200,000 and the

Whistleblower Office, the Office has made $1.1 billion in awards (based on a collection of $6.6 billion) since 2007.[146] "In FY 2022, the IRS paid whistleblowers 132 awards totaling $37.8 million from proceeds collected of $172.7 million."[147] Monetary awards like those described above can create an incentive for whistleblowers to share information with the IRS.[148]

That said, it is worth noting that tax whistleblowers "likely have mixed motives" that also include "potential grants of immunity for their own culpable conduct, their own morals, [and] other considerations."[149] Whatever their motives, research suggests "whistleblowers will *not* be motivated if they perceive that the Service is unlikely or unwilling to act upon their information."[150] Over the life of the program, the IRS has struggled to process the large volume of whistleblower claims, creating delays that may discourage participation in the program.[151] By 2013, the IRS already had a backlog of over 22,000 whistleblower claims.[152] As of 2023, there were 28,027 open whistleblower claims.[153] Given this volume, the IRS needs procedures to help identify and prioritize the most promising tips.

Professors Karie Davis-Nozemack and Sarah Webber have argued that the whistleblower program would be more efficient if the IRS consistently debriefed whistleblowers who submit claims.[154] Debriefing would entail interviewing the whistleblower to collect additional "information for procedural, substantive, and programmatic purposes" and to "shed light on the motivation and reliability of the whistleblower."[155] Such debriefing could help the IRS maximize the potential of the existing whistleblowing program to collect relevant information, and it would help the agency determine which claims are worth pursuing. Ultimately, debriefing whistleblowers could help

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proceeds in dispute exceed $2 million. Whistleblowers who make less substantial contributions are entitled to smaller awards under I.R.C. § 7623(b)(2).

146. I.R.S. WHISTLEBLOWER OFF., FISCAL YEAR 2022 ANN. REP. 5 (2022).

147. *Id.* at 4. Of these awards, twenty-six were large mandatory awards under I.R.C. § 7623(b). *Id.* Those whistleblowers were responsible for the $152.7 million of the collections (88.4 percent of the total collected from whistleblower claims) and received $34.5 million in awards. *Id.* However, most whistleblowers claimed smaller, discretionary awards available under I.R.C. § 7623(a). *Id.* The office granted 106 discretionary awards, paying whistleblowers "$3.3 million attributable to proceeds collected of $20.0 million." *Id.*

148. Davis-Nozemack & Webber, *supra* note 65, at 330.

149. *Id.* at 329–30.

150. *Id.* at 330 (emphasis added).

151. *Id.* at 334–47. Even when the IRS responds promptly to a whistleblower claim, "the IRS generally cannot make award payments for several years after the whistleblower has filed a claim." I.R.S. WHISTLEBLOWER OFF., FISCAL YEAR 2022 ANN. REP. 7 (2022). This is because no award can "be made until the taxpayer has exhausted all appeal rights and the taxpayer no longer can file a claim for refund or otherwise seek to recover the proceeds from the government." *Id.*

152. Davis-Nozemack & Webber, *supra* note 65, at 322.

153. I.R.S. WHISTLEBLOWER OFF., FISCAL YEAR 2022 ANN. REP. 26.

154. *See generally* Davis-Nozemack & Webber, *supra* note 65 (arguing the whistleblower program would be more efficient if the IRS consistently debriefed whistleblowers submitting claims).

155. *Id.* at 363.

the whistleblower program reach its potential to help the IRS close the tax information gap. However, debriefing would also require the IRS to share the targeted taxpayer's information with the whistleblower, raising important privacy concerns.[156]

In 2019, Congress enacted I.R.C. § 6103(k)(13) to authorize disclosure of "return information related to the investigation of any taxpayer with respect to whom the individual has provided such information, but only to the extent that such disclosure is necessary in obtaining information, which is not otherwise reasonably available."[157] However, the new statute does not place any confidentiality obligations on whistleblowers.[158] For this reason, the agency has stated that, "the IRS has no legal authority to restrain whistleblowers from re-disclosing third-party taxpayer information disclosed during administrative and judicial processes, and continues to struggle when applying existing disclosure standards to determine what third-party return information should be disclosed."[159]

Taxpayers' privacy could be better protected by amending I.R.C. § 6103(k)(13) to impose confidentiality obligations on whistleblowers. Such requirements would not eliminate the privacy violation experienced by the taxpayer, who may still object to their return information being shared with a whistleblower. However, some privacy loss is inevitable in the enforcement context, and whistleblower proceedings are narrowly targeted to noncompliant taxpayers. This feature reduces the extent to which the privacy rights of compliant taxpayers would be violated by forced disclosures to third parties. Moreover, statutory requirements that prohibit whistleblowers from sharing the taxpayers' confidential information would minimize harm to the targeted taxpayer. In this way, the law could help maximize the information gathering potential of the whistleblower program while minimizing privacy violations.[160]

## CONCLUSION

Closing the tax gap—and the tax information gap—is essential not only to achieve revenue raising goals, but also to ensure that the tax system is equitable. The current system suffers from enforcement challenges that

156. *See id.* at 342.

157. I.R.C. § 6103(k)(13) (2024).

158. *See id.*

159. I.R.S. WHISTLEBLOWER OFF., FISCAL YEAR 2022 ANN. REP. 17.

160. Note that whistleblower litigation may "also present[] concerns with regard to the disclosure of the identity of the whistleblower and other information to the public." Morse, *supra* note 134, at 26. However, I.R.C. § 7461(b)(1) empowers the Tax Court to seal records when "necessary to prevent the disclosure of trade secrets *or other confidential* information." *See* I.R.C. § 7461(b)(1) (2024) (emphasis added). In addition, Tax Court Rule 345 allows whistleblowers to move the Court for permission to proceed anonymously, T.C. Rule 345, and Rule 103 authorizes various protective orders "to protect a party or other person from annoyance, embarrassment, oppression, or undue burden or expense." T.C. Rule 103 (providing privacy protections for filings in whistleblower actions); *see also* Whistleblower 11332-13W v. Comm'r, 107 T.C.M. (CCH) 1471, 1471 (2014) (sealing the record to protect the whistleblower from "severe physical harm" and to protect its "professional reputation, economic interests and personal safety").

disproportionately benefit the wealthy. Namely, one of the IRS's most effective enforcement tools, information reporting, often fails to collect relevant information about high-end taxpayers. The status quo is not an option. Blank and Glogower have proposed an ambitious reform that would increase the agency's power to collect information about wealthy and high-income taxpayers. They have convincingly argued that an actor-based approach, which would subject high-end taxpayers to heighted information reporting requirements, would be more efficient and equitable than the existing system. This alone may be reason to adopt their proposal.

Nevertheless, this Response has highlighted a fourth tax policy objective—privacy—that may suffer under an actor-based information reporting regime. It has argued that actor-based reporting may present more privacy risks than the existing regime, and other approaches to information collection may be less invasive. Namely, an incentive-based approach may have some privacy advantages over the actor-based approach. Through privacy-based analyses of the actor-based information reporting proposal and several examples of incentive programs, this Essay has demonstrated how a tax privacy objective can inform evaluations of enforcement proposals. That said, this Essay aims to begin a privacy debate over tax information collection. It does not attempt to provide the final word on tax information reporting, or to determine which of the proposals discussed would be the most promising way forward. These are tasks for policymakers, who must balance privacy objectives against other important tax policy objectives. Tax privacy cannot—and probably should not—be the priority in tax enforcement. Nevertheless, it would be dangerous to ignore it entirely.