This article describes general principles and specific practices to improve compliance and enforcement of the personal income tax (PIT), based on the U.S. experience with the tax. An earlier version of this article was presented to a 2011 international symposium in China whose purpose was to prepare for possible changes to China’s PIT system in view of economic and other developments in the country. Currently about thirty years old, the Chinese PIT system very roughly resembles the U.S. PIT system at a similar age (prior to changes effected during World War II).

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I. INTRODUCTION

This article describes general principles and specific practices to
improve compliance and enforcement of the personal income tax (PIT),
based on the U.S. experience with the tax. Facilitating compliance and
enforcement is, of course, only one of a number of objectives in designing
any tax system. It is arguably the most fundamental goal of a tax system,
however, since noncompliance potentially undermines all other policy
objectives, including vertical equity, horizontal equity, and efficiency.

Part II provides a brief overview of the U.S. federal tax system and
describes the U.S. experience in monitoring and controlling the federal “tax
gap,” the difference between the tax owed and the amount paid voluntarily
by taxpayers on a timely basis. Part III then describes the principles and
practices for enhancing PIT compliance and enforcement. Part IV contains
a brief conclusion.
II. BACKGROUND ON U.S. FEDERAL TAXES AND THE “TAX GAP”

A. Trends in U.S. Federal Taxes

Figure 1 shows the major U.S. federal taxes as a percentage of GDP for fiscal years (FY) 1934–2016 (data for FY 2011–2016 is estimated). The figure reveals several important trends during this period. First, total federal taxes increased dramatically from about 5% to over 20% of GDP just prior to and during World War II, and such taxes have generally remained between 17% and 20% of GDP ever since. Taxes rose principally to pay for the costs of the War, but remained at their increased level following the War to finance the country’s heightened post-War global responsibilities as well as increased federal government commitments resulting from the New Deal and subsequent legislation.

Second, the federal PIT as a percentage of GDP also increased significantly during the same period, from under 1% in 1934 to over 9% in 1944. Since then, despite many, many changes to the law, the federal PIT has generally remained between 7% and 9% of GDP. During World War II, the federal PIT changed from being primarily a “class tax,” generally affecting only a small, high-income fraction of the U.S. population, to a “mass tax,” affecting a broad segment of society.¹

Finally, Figure 1 illustrates the steadily increasing role of social insurance taxes (from 0.1% of GDP in 1936 to about 6% currently) and the generally declining role of the federal corporate income tax (CIT) and other taxes (principally, excise and estate and gift taxes) during the same period. The growth in social insurance taxes largely reflects enactment of Social Security in 1935 and Medicare in 1965. The decrease in the federal CIT principally has resulted from legislative amendments, changes in cross-border investment patterns (and their consequences under international tax rules), and an increase in the number of businesses and amount of business income taxed under the PIT rather than the CIT. Overall, Figure 1 shows that during the last seventy years, the federal PIT has been an important source of revenue for the United States, producing between 40% and 50% of total federal revenue during that time.

B. The U.S. Federal “Tax Gap”

For a number of years, the United States has estimated the size of the federal “tax gap,” defined as the difference between the amount of federal taxes owed from legal activities and the amount actually paid on a timely basis. The overall federal tax gap consists of three components — the “nonfiling gap,” the “underreporting gap,” and the “underpayment gap” — which refer to the amount of tax not paid due to a taxpayer’s failure to file a tax return, to report the full tax liability on the return, and to pay the liability reported, respectively.\(^2\) The size of the federal tax gap is a rough measure of the effectiveness of U.S. federal tax administration.

The most recent estimates, from FY 2006, show a gross tax gap of $450 billion, or about 16.9% of total taxes due.\(^3\) About $2.2 trillion of federal tax was paid voluntarily on time.\(^4\) Although the tax gap estimates are necessarily rough, the estimated federal tax compliance rate has consistently averaged between 80–84% over approximately the last thirty years.\(^5\) Of the gross tax gap, $65 billion was eventually collected as a result of either voluntary (though untimely) payments by the taxpayer or Internal


\(^{4}\) “Voluntary” includes tax payments made through annual tax returns, estimated tax payments, or withholding.

\(^{5}\) See, e.g., IRS, FEDERAL TAX COMPLIANCE RESEARCH: INDIVIDUAL INCOME TAX GAP ESTIMATES FOR 1985, 1988 & 1992 (1996), at 6 tbl. 2; Marcuss, supra note 2, at 888.
Revenue Service (IRS) enforcement efforts; this collection reduced the net tax gap to about $385 billion, or about 14.5% of total federal taxes due.\(^6\)

Figure 2 shows the estimated size of each component of the 2006 gross tax gap. The major contributor to the gap was underreporting, which amounted to $376 billion, or 83.6% of the gross gap. The three largest elements of the underreporting gap were underreporting of the PIT ($235 billion, or 62.5% of the underreporting gap), employment taxes ($72 billion, or 19.1% of the underreporting gap), and the CIT ($67 billion, or 17.8% of the underreporting gap).\(^7\)

**FIGURE 2: COMPONENTS OF U.S. FEDERAL GROSS TAX GAP, FY 2006 ($B)**


Figure 3 examines the reasons behind the two largest elements of the underreporting tax gap, and illustrates that over half of PIT underreporting (about $122 billion) was attributable to "business income," which is principally income of sole proprietors. In addition, almost eighty percent of underreporting of employment taxes ($57 billion) was attributable to the self-employment tax, a tax owed principally by sole proprietors. Figure 3, therefore, suggests that an important cause of the tax gap was noncompliance by sole proprietors.

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\(^6\) See IRS, *supra* note 3.

Figure 4 generalizes the implication of Figure 3 by separating the amount of PIT underreporting into four categories, based upon the “visibility” of the income tax item to the IRS. Where there was substantial information reporting and withholding, as in the case of wage and salary income, the net misreporting percentage (“NMP”) (defined as the net misreported amount of income as a ratio of the correct amount) was only about 1%. For items having substantial information reporting (but no withholding), such as interest, dividend, and pension income, the NMP was about 8%. Where there was some information reporting, such as certain pass-through business income, capital gains, and certain deductions and exemptions, the NMP was about 11%. Finally, for items with little or no information reporting, such as sole proprietor income, rents, royalties, farm, and other income, the NMP was over 50%. Overall, Figure 4 shows the intuitive result that the more visible a tax item is to the IRS, the lower the noncompliance.
The IRS’s tax gap estimates are developed through its National Research Program (NRP). A principal component of the NRP is annual audits that are somewhat more thorough than regular, operational audits. Importantly, both the taxpayers and issues selected for the NRP audits are determined through random sampling techniques in order to allow audit results to be extrapolated to the entire population with accuracy. The results of the NRP audits provide the data for the tax gap estimates and also assist in developing the nonrandom selection indicators (“red flags”) for operational audits. This research therefore helps to make operational audits more targeted, less burdensome on taxpayers, and more efficient.

Each component of the tax gap is determined differently. The “underpayment gap” is generally estimated from IRS records based on a comparison of the tax amounts reported and actually paid on time. The “nonfiling gap” is much more difficult to estimate since, by definition, the estimate relates to taxpayers who have not formally revealed any tax information to the IRS. The nonfiling gap is estimated based on a model using demographic and economic information collected by the U.S. Census.


See Marcus, supra note 2, at 887, 893.

See id. at 889.

See id. at 892-93.
Bureau for nontax purposes. Importantly, in order to protect the privacy of individuals and the integrity of the data collection for nontax purposes, there is no individual-level matching of Census information and tax information; all estimates are determined based on aggregate information.\(^\text{12}\) The confidentiality protection means that the IRS is unable to develop any individual-level characteristics of nonfilers, such as the propensity of law professors not to file tax returns.

Finally, the “underreporting gap” is estimated based on an extrapolation of the NRP audit results.\(^\text{13}\) The random sample of returns is stratified to ensure that there are a sufficient number of high-income and business-income taxpayers contained in the sample. During the mid-1990s, Congress temporarily barred the conduct of NRP-type audits due to complaints from affected taxpayers.\(^\text{14}\) Eventually, the IRS refined its selection technique to reduce the number of returns and issues audited, while preserving the statistical significance of the data collected, and the audits resumed. As previously noted, the NRP audits are an important source of information to improve the efficiency of operational audits by updating the validity of all “red flags” and, therefore, the reinstitution of the NRP was an important step towards maintaining sound tax administration. The most recent underreporting gap estimates for the CIT reflect the use of statistical techniques to produce NRP-type results based on data from (nonrandom) operational audits.\(^\text{15}\) This is an important development, given the widespread tax auditing at an operational level of many major U.S. corporations.

III. PRINCIPLES AND PRACTICES TO ENHANCE COMPLIANCE AND ENFORCEMENT OF THE PIT

A. General Objectives of Tax Administration

Proper tax administration must always weigh both the costs and

\(^{12}\) See id. at 892.

\(^{13}\) See id. at 893.

\(^{14}\) See Ryan J. Donmoyer, IRS Delays TCMP Start Until December, 68 TAX NOTES 1389 (1995); Ryan J. Donmoyer, Year in Review: For the IRS, “Pivotal” Year Contains Its Share of Setbacks, 70 TAX NOTES 15 (1996); George Guttman, Who Should the IRS Be Auditing?, 86 TAX NOTES 1533 (2000) (describing the delay and ultimate suspension of the Taxpayer Compliance Measurement Program, the predecessor to the NRP, and the impact on IRS audit capability).

benefits of any tax enforcement initiative. Reducing the tax gap, for example, may increase the amount of revenue raised and improve fairness and taxpayer morale. It may also improve the efficiency of the tax system, by reducing the tax bias in favor of those sectors where paying taxes is easy to evade, and also discouraging wasteful tax avoidance activities by taxpayers. But tax gap reduction may also entail substantial costs, including the administrator’s cost of enforcement, increased recordkeeping and other burdens on taxpayers and third parties, and intrusion on privacy rights. Strengthened enforcement may also increase tax avoidance costs as taxpayers utilize more and more convoluted means to avoid their tax responsibilities. The weighing of costs and benefits means that the largest tax gap areas may not be the ones where enforcement efforts should be directed. Although those areas may represent the most lucrative source of potential tax revenue, they also likely represent the areas where enforcement costs will be highest; indeed, the tax gap may be largest in those areas because enforcement is so difficult.

In the United States, the principal goal of PIT administration has been to promote true, voluntary compliance on the part of taxpayers, where they internalize their societal obligations to report accurately and pay their full tax liabilities. This approach is thought to be the most cost-effective method of collecting taxes, and also most likely to induce acceptance of the PIT on the part of the American public. Admittedly very ambitious, the goal represents a cultural value of a society that can be cultivated over time.

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18 See Marcuss, supra note 2, at 889.
19 According to Professor Brownlee, promoting voluntary compliance was part of the government’s strategy to gain quick, widespread acceptance of the PIT when it was dramatically expanded during World War II: “In making the new individual income tax work, the Roosevelt administration relied heavily on voluntarism by encouraging the self-reporting of income. Roosevelt, [Treasury Secretary] Morgenthau, and the congressional leadership all were reluctant to impose a highly coercive system of assessment and collection.” BROWNLEE, supra note 1, at 116 (footnote omitted). The Roosevelt administration also carried out a mass communication campaign to convince the American public of the fairness and simplicity of the new PIT. Id. at 117–19.
Depending upon how it is carried out, tax enforcement can help to promote or detract from development of this value.\textsuperscript{21} In general, tax enforcement efforts should be fully integrated with service to taxpayers in the form of education and assistance.\textsuperscript{22} Other key steps to promote development of a "positive tax culture" include: (1) a legal system to resolve disputes fairly, protect privacy and other human rights, and provide rules and rule creation in a transparent manner, (2) accounting systems that are familiar, reliable, and uniform, (3) a budget and a political system that provide transparency as to both the collection and disbursement of all tax revenue, (4) an effective taxpayer identification system for both individuals and businesses, (5) tax law and tax policy that are conducive to sound and effective tax administration, and (6) tax administration, research, and data analysis that are conducted with integrity and trust.

\textbf{B. Reducing the PIT Nonfiling Gap}

The PIT nonfiling gap does not appear to be a major U.S. problem, as it was estimated to be only about six percent of the gross tax gap in FY 2006. It may be a larger problem, however, for countries with less mature PIT systems and less well-developed economies; for these countries, "off-book" ("shadow") transactions may be more common, and there may not be a long history of large numbers of taxpayers filing income tax returns. There are many potential benefits from reducing the PIT nonfiling gap, including the collection of both current and future taxes once a taxpayer is included in the tax system, fairness and improvement of taxpayer morale, collection of more comprehensive economic and tax data, and promotion and development of a positive tax culture.

One method of reducing the PIT nonfiling gap is by using information


\textsuperscript{22} The IRS's "Mission Statement" is to "provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all." 2011-2 I.R.B. ii (Jan. 10, 2011).
obtained through the PIT system itself, such as withholding and information reports provided by third parties. Although it may be difficult to reconstruct the precise amount of a taxpayer's income from information reports, such reports can be quite helpful in identifying nonfilers.

Another method is to utilize information available from non-PIT sources and institutions. Important threshold questions for the tax administrator with respect to this type of information are whether the government can gain access to it for PIT enforcement purposes and whether, as a policy matter, the government should do so. As noted, the United States has a policy of not using individual-level Census Bureau information for tax enforcement purposes in order to protect the quality of that data for nontax purposes.

Potentially helpful non-PIT sources of information include: (1) census information, (2) information available through the Social Security system, (3) records of licenses and registrations to operate business (both corporate and noncorporate) and to satisfy health, environmental, labor, and other regulatory purposes, (4) financial records, including bank and securities holdings and credit card records, (5) records of real estate transactions, (6) tax filings for non-PIT purposes, such as the VAT or property taxes, and (7) filings of the existence of offshore assets and activities. In 2009, the United States successfully negotiated to obtain information of U.S. persons with accounts with the Swiss bank, UBS, and this information is expected to lead to a number of tax prosecutions.23

Although not part of the PIT "nonfiling gap," some taxpayers do not file annual tax returns because they are part of a "final withholding" system that allows them to pay their full income tax liabilities through withholding.24 A potential advantage of final withholding is the reduction of taxpayer compliance burdens. A potential disadvantage, however, is a possible blurring of the message that responsibility for reporting and paying the PIT ultimately belongs to the taxpayer and not some third party. Annual

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24 For example, the United Kingdom permits final withholding through its Pay As You Earn system. See HUGH J. AULT & BRIAN J. ARNOLD, COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS 162–64 (3d ed. 2010).
tax returns, thus, may better promote the perception that everyone is part of the tax system, and thereby help in the development of a positive tax culture.\textsuperscript{25} Tax return filing can also convey uniform accounting practices, require useful taxpayer attestations, and permit collection of more comprehensive taxpayer information. The United States, for example, includes on its PIT tax return a question about the existence of certain offshore financial interests, and directs the taxpayer to other potential disclosure requirements if such an interest exists.\textsuperscript{26} The requirement to disclose such interests was recently expanded.\textsuperscript{27}

The United States generally requires taxpayers to file annual PIT returns on which the prior payment of taxes through withholding and estimated tax payments is reconciled.\textsuperscript{28} In FY 2008, about 89 million individual and 54 million joint income tax returns were filed, representing tax returns for about 197 million \((89 + (54 \times 2))\) individuals.\textsuperscript{29} This number represented at least 65\% of the United States's estimated population of 304 million in that year.\textsuperscript{30} There have been proposals in recent years for the United States to develop a "final withholding" system similar to the one utilized in the United Kingdom.\textsuperscript{31} Even if the United States were to move in


\textsuperscript{26} See 31 U.S.C. § 5314 (required disclosure under Bank Secrecy Act). One taxpayer's failure to respond accurately to this question and to make the required FBAR filing was instrumental in a successful UBS-related criminal prosecution. See Dep't of Justice, http://www.justice.gov/opa/pr/2011/August/11-tax-1003.html.


\textsuperscript{28} I.R.C. § 6012.

\textsuperscript{29} See IRS, SOI Historical tbl.1, http://www.irs.gov/taxstats/article/0,,id=188060,00.html.


\textsuperscript{31} See William G. Gale \& Janet Holtzblatt, \textit{On the Possibility of a No-Return Tax System}, 50 \textit{Nat'l Tax J.} 475 (1997) (explaining major trade-offs if no-return system were adopted in United States). Professor Bankman has urged a slightly different reform that would require the IRS to provide certain taxpayers with completed returns for their approval
that direction, however, that choice may not be optimal for a country whose population has not yet internalized the individual obligation to report and pay taxes.

A direct method of promoting annual tax returns is to require taxpayers satisfying some high-income threshold to file a return even though they have already paid tax through withholding.\textsuperscript{32} Higher income taxpayers are most likely to have both useful information that would be revealed on a tax return, and the ability to file such a return. If the threshold amount is left unindexed and is based on comprehensive (rather than taxable) income, the filing requirement can gradually be spread to a larger segment of the population. An indirect method of requiring returns is to overwithhold and require taxpayers to obtain refunds through the return filing process.\textsuperscript{33} This approach has the potential disadvantage of requiring the "wrong persons" (i.e., middle- and lower-income taxpayers) to file since they may be more likely to be overwithheld. Still another method (with the same general disadvantage) is to require taxpayers to file tax returns in order to obtain certain government benefits (such as subsidies for low-income persons); the United States delivers its Earned Income Tax Credit (EITC), a benefit generally provided to low-income workers with family obligations, in this manner. In 2008, about 25 million taxpayers filed tax returns to claim EITC benefits totaling about $51 billion.\textsuperscript{34}

\textbf{C. Reducing the PIT Underreporting Tax Gap}

1. Withholding

The withholding of income tax liabilities at the source of the income is an important tool to reduce the underreporting tax gap. Taxpayers have an incentive to make sure that any amounts withheld are properly documented and credited to them; this attitude reverses any incentive the taxpayer may originally have had to conceal the income and tax liability, and tends to enhance the quality of the recordkeeping and reporting of the income and withheld amounts. Withholding may also spread out the payment of a tax liability over a period of time and thereby reduce the likelihood that income

\begin{itemize}
\item It is my understanding that China already has a requirement such as this.
\item In 2008, almost 112 million individual and joint income tax returns claimed refunds in the United States, representing over 75% of the returns filed. See IRS, \textit{Tax Stats at a Glance}, http://www.irs.gov/taxstats/article/0,,id=102886,00.html. It is unclear how many refunds were attributable to an affirmative taxpayer choice to use tax withholding as a form of "forced savings."
\item \textit{Id.}
\end{itemize}
is ultimately underreported and tax not fully paid. The United States has required withholding of tax liabilities on wage and salary income since 1943, and also requires withholding of certain other types of income, such as certain retirement and deferred income and gambling winnings. 35

An important limitation on withholding is the agent’s lack of knowledge regarding the amount to withhold. To withhold properly, the withholding agent must know both the tax rate applicable to the taxpayer and the extent to which a given payment represents income to the taxpayer. In any given case, it may be difficult for the agent to learn either of these two facts. Withholding is frequently imposed on wage and salary income because there may be few, if any, deductions that would reduce the income amount below the amount of the agent’s payment. In addition, wages and salaries represent the bulk of income for many taxpayers; thus, the amount of payment is often determinative of the tax rate applicable to the taxpayer.

In 1982, the U.S. Congress approved a ten percent withholding tax on certain categories of interest and dividend income. Interest subject to withholding included most interest paid by entities, including interest paid by the federal government. Dividends subject to withholding included most distributions of money or other property by corporations to their shareholders. 36 After its enactment, the withholding tax came under sharp criticism because of its compliance burdens on the withholding agent, and purported unfairness to “small savers” (including the elderly), and Congress repealed the tax before it ever went into effect. 37 It is possible that, with the help of current technology and the use of exemption certificates, interest and dividend withholding might be implemented today without difficulty. Because, however, there is comprehensive information reporting with respect to such income, and compliance is believed to be quite high, there is

35 I.R.C. §§ 3402, 3405. The United States first used income tax withholding on a selective basis during the Civil War, and also requires withholding of social insurance taxes. See I.R.C. § 3102; Brownlee, supra note 1, at 35, 112–14. The Revenue Act of 1913, the first law of the modern PIT, included a broad income tax withholding requirement, but it was repealed in 1917 (and replaced by information reporting) due to the administrative difficulties of implementing withholding. See War Revenue Act of 1917, Pub. L. No. 65-50, 40 Stat. 300-338 (1917), §§ 1204(2), 1211 (repealing section 8(d) of, and adding sections 27 and 28 to, the Revenue Act of 1916, Pub. L. No. 64-271, 39 Stat. 756-801 (1916)).


presently no strong interest in Congress to extend withholding to this income.

More recently, Congress approved in 2006 a three percent withholding tax on certain payments made by governmental entities to persons providing property or services to such entities. This tax was enacted following reports of high rates of tax noncompliance on the part of government contractors. The tax, however, was criticized because of its imposition of compliance costs on governments and unfair cash-flow burdens on certain taxpayers, and was repealed at the end of 2011 without ever taking effect.

In summary, tax withholding has been an important, but limited, tool in the United States to ensure PIT compliance. Other than wages and salaries, the principal area where withholding is imposed is on payments to nonresidents. Tax withholding on the income of nonresidents is often justified as the final opportunity for the source country to collect the tax, and is commonly employed worldwide. Aside from the difficulty determining the proper amount to withhold, withholding can present liquidity problems if an income item is not in cash, and also raises questions regarding the cost to, and reliability of, the withholding agent.

2. Information Reporting

The United States requires information reporting to both the taxpayer and the IRS of over one hundred specific types of payments. Among the most common categories of income for which reporting is required are

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38 Pub. L. No. 109-222, 120 Stat. 345 (2006), § 511(a) (adding new Code section 3402(t)).
40 Pub. L. No. 112-56, 125 Stat. 711 (2011), § 102; see Bickley, supra note 39, at 5–6 (describing legislative interest in repeal).
42 See AULT & ARNOLD, supra note 24, at 495.
wages and salaries, dividends, interest, income allocable to owners or beneficiaries of pass-through entities (such as partnerships, limited liability companies, S corporations, and certain trusts), retirement income, tax refunds, and Social Security benefits. Information reporting is also required of amounts that are potentially deductible or creditable by the taxpayer, such as mortgage interest payments, certain charitable donations, and education expenses. Information reporting of salary, dividend, and interest payments has been required since almost the very beginning of the modern PIT system.

One common way to implement information reporting is to impose the obligation on a third party who stands to obtain some type of tax benefit from the amount reported, such as a deduction, tax credit, or record of cost basis in an asset acquired. A familiar example is information reporting of wages paid by an employer that deducts the expense. The United States, however, also requires persons who are not employers, but who are engaged in a trade or business, to file information reports of payments (which would ordinarily be deductible) to certain service-providers, if such payments total $600 or more in a year. The availability of a tax benefit to the third-party reporter provides greater assurance that the information reporting obligation will be carried out satisfactorily, since the reporter has an independent (and self-interested) reason to keep track of the amount reported. In certain cases, the reporter's tax benefit is conditioned on the filing of an information report. Countries with both a credit-invoice VAT system and a PIT may be able to use VAT-generated reports as information reports for the PIT.

Information reporting may also be successfully required in the case of a series of payments periodically made by a payor to the same payee. Examples include the reporting of interest and dividend payments by financial institutions and corporations. Under this principle, information reporting could conceivably be extended to periodic rental, lease, or royalty payments made by a lessee-user to a lessor-owner.

The United States has also relied heavily on information reporting by third-party intermediaries (as opposed to the person engaged in the

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44 See I.R.C. §§ 6050H, 6050L & 6050S.
45 See supra note 35; BROWNLEE, supra note 1, at 70.
46 I.R.C. § 6041. Recent legislation that expanded this requirement proved controversial, however, and the expansion was promptly repealed. Pub. L. No. 112-9, 125 Stat. 36 (2011), § 2.
47 See, e.g., I.R.C. § 21(e)(9) (conditioning availability of dependent care credit on proper identification of dependent care provider).
48 I.R.C. §§ 6042, 6049.
49 See I.R.C. § 6050N (setting forth requirement for certain royalty payments).
economic transaction with the taxpayer). For example, if a taxpayer sells securities, a brokerage firm may serve as an intermediary between the taxpayer and the buyer. In the United States, brokerage firms have broad responsibilities for reporting tax information to their customers and the IRS, including the gross proceeds received from securities transactions and the customer's basis in securities sold. A recent provision requires certain merchant banks to report the amount of gross credit card receipts of their customers. The Treasury and IRS hope that the new credit card information reporting will help to reduce noncompliance among sole proprietors and small businesses.

Another area where the IRS has successfully employed information reporting by third-party intermediaries to reduce PIT underreporting is tip reporting. In 1981, according to preliminary estimates by the IRS, the compliance rate with respect to tip income was only about 16%. The only category of income with a lower compliance rate was illegal income, which had an estimated compliance rate of 5%. Prior enforcement efforts to improve compliance of tip income had been largely unsuccessful because of the large number of irregular transactions involving fairly small amounts of cash. In 1982, Congress adopted a provision requiring certain large food and beverage establishments to file information reports allocating 8% of the establishment's gross receipts among its employees as tip income received by them. Eight percent was selected because it was just slightly greater than one-half of the standard average tip at the time (15%). The reporting burden was placed on the food and beverage establishment because it was thought to be in the best position to determine the amount that should be allocated to each employee. Subsequent IRS data has shown clear improvement in the reporting of this category of income.

A principal difficulty with information reporting is ensuring the accuracy of the report. Like withholding, information reporting is only as effective as the reliability of the reporting agent. In addition, in contrast to their attitude towards withholding, taxpayers have an incentive to conceal

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50 I.R.C. §§ 6045, 6045A & 6045B.
51 I.R.C. § 6050W.
53 I.R.C. § 6053(c).
their proper identity from the reporting agent, and there is a limit regarding how much investigative burden can be placed on the agent. The United States has an on-line taxpayer identification number-matching program that enables certain withholding and reporting agents to check the veracity of taxpayer identification information provided them by the taxpayer. The use of this program is carefully circumscribed to protect privacy interests.

More generally, information reporting presents the potential problem of both “too much” and “too little” information being provided to the tax administrator. As a result, the principal value of information reporting may be to assist taxpayers in filing more accurate returns and to help the IRS to identify nonfilers and specific instances of underreporting. In addition, information reporting may have a useful in terrorem effect on taxpayers who might otherwise be inclined to underreport their tax obligations.

3. Tax Audits

Effective tax administration must involve some level of real and perceived auditing. Auditing, however, is a potentially costly tool, in both monetary and nonmonetary terms, to the administrator and the taxpayer. Moreover, auditing that is perceived to be too widespread and draconian could potentially detract from the development of a positive tax culture and internalization by taxpayers of their voluntary obligation to pay tax. U.S. PIT audit rates are quite low and have fallen from earlier periods. In 2011, the overall PIT audit rate, and that for taxpayers with income of $200,000 or more and $1 million or more, was about 1%, 4%, and 12.5%, respectively, and these statistics include both “correspondence” audits and actual field examinations. The audit rate of businesses organized in corporate and partnership form was similarly low; the overall rate was under 1% in 2011, with about 18% of large corporations (those with assets of $10 million or more) audited.

In general, the better targeted the audit, the greater the potential benefit relative to its cost. Selected issues (those setting off “red flags”) of higher-

57 Increased use of electronic filings should mitigate some of the administrative burden.
58 See Frey & Jegen, supra note 21.
59 See Joel Slemrod & Jon Bakija, Taxing Ourselves 180 (4th ed. 2008) (reporting overall audit rate of about four percent during the 1960s).
income taxpayers (who are likely to have more tax items in dispute with larger tax liability consequences) should be disproportionately audited. The need to identify appropriate red flags highlights the importance of good tax research and analysis.

4. Reducing Noncompliance by Small Businesses and from Capital Gains

As Figures 3 and 4 indicated, noncompliance by sole proprietors and small businesses is believed to be a principal cause of the U.S. tax gap. Yet the enforcement costs to improve compliance on the part of any given business may be quite high relative to the additional tax that might be collected from such business. In addition, strengthened enforcement may have the undesirable consequence of encouraging more businesses to operate in the "shadow" economy, outside of both tax and nontax regulations.

In deciding what level of resources to devote to this problem, tax administrators must consider some of the collateral benefits of improved compliance in this sector, including increased taxpayer morale and reduction in the tax bias in favor of the sector (because taxes are not well enforced). Indeed, assuming that the bias tends to encourage greater investment in the sector (and therefore a reduction in pre-tax rates of return), the biggest loser of the noncompliance may be those small businesses that do comply fully with their tax obligations. It may be more sensible to impose reduced tax rates in this sector (but with strengthened enforcement) than simply to allow the sector to be largely untaxed through inattention by the tax authorities. The same advice is generally true in taxing small businesses in a credit-invoice VAT system.

The taxation of capital gains also presents a special tax enforcement problem because such gains generally arise only at such time as the taxpayer chooses. This feature makes it hard for the administrator to monitor the existence of the income and also raises important policy issues regarding the taxation of the gain, such as the problems of "lock-in" (the deterrence of economically desirable transactions because of their tax consequences) and "bunching" (the taxation at one time of gains accruing over a period of time, with the bunching of income pushing the taxpayer into a higher tax bracket). In addition, the voluntary nature of the taxable event generally requires limitations on the deductibility of capital losses.63

61 See SLEMROD & BAKIJA, supra note 59, at 180.
63 In the United States, capital losses of individuals are deductible only up to the
The United States has long required information reporting by brokerage houses of the gross proceeds received by their customers on sale of their securities.\textsuperscript{64} In general, the United States has not required withholding on such payments since the brokerage house may not have knowledge of how much of the proceeds, if any, represents income to the customer. One exception, where a ten percent withholding tax is imposed, is on certain sales of U.S. real property interests by nonresident sellers; the withholding tax in that situation is justified because of the difficulty of collecting tax in any other way.\textsuperscript{65} Now that brokerage houses must generally report their customer's "basis" (generally, the customer's cost) in any securities sold in the same transactions for which gross proceeds must be reported, it may be feasible in the future to require tax withholding by the broker.\textsuperscript{66} Whether Congress takes that step may depend upon the experience with the new basis reporting requirement and how much it improves compliance.

\textit{D. Income Tax Rate Structure}

The income tax rate structure obviously implicates important policy considerations other than facilitating tax administration. If focus is primarily on the latter objective, however, an ideal structure would have a relatively flat rate with few (and wide) brackets. For example, the tax system might have a zero-rate bracket for the low-income, a single low-rate bracket applicable to a broad spectrum of middle-income and upper-middle-income taxpayers, and a high-rate bracket for high-income taxpayers. Such a system would be simple and transparent for most taxpayers, and would minimize their incentive to engage in wasteful income-shifting activities between different taxpayers and across taxable periods of the same taxpayer. In addition, it would facilitate widespread use of withholding. If the withholding rate were set at the single low tax rate applicable to most taxpayers, the main administrative hurdle would be to exempt zero-bracket taxpayers from withholding (such as through the use of exemption certificates). If desired, "final withholding" could probably be achieved for a large number of taxpayers.

The rate structure should incorporate an adjustment to accommodate different tax unit characteristics, such as single or married status, single taxpayer's capital gains plus $3000 of ordinary income each year. Excess capital losses may generally be carried forward indefinitely for deduction in subsequent years. I.R.C. §§ 1211(b), 1212(b).

\textsuperscript{64} I.R.C. § 6045(a), (b).
\textsuperscript{65} I.R.C. § 1445.
\textsuperscript{66} I.R.C. §§ 6045(g), 6045A & 6045B.
heads of household, and taxpayers with young children and other dependents. In addition, the bracket widths should probably be indexed to inflation to avoid the need to make periodic, *ad hoc* adjustments to the brackets.

The PIT rate structure should be coordinated with any separate rate structure applicable to corporations or enterprises because of the possibility of taxpayers dividing (or shifting) their income-producing activities between the two systems. Thus, any discrepancy in the applicable tax rates will simply raise enforcement problems for the tax administrator.

In 2011, the U.S. PIT system generally exempted a married couple without children from paying income tax if the couple had taxable income of up to $19,000. For taxpayers with children, the exempt amount was increased by an amount per child equivalent to $3,700 of taxable income plus a $1,000 tax credit. Additional provisions (such as the EITC and other tax credits) exempted (and in some cases provided positive benefits to) additional taxpayers. The United States, however, also has significant social insurance taxes; in general, these taxes are imposed on the first dollar of labor income without exemption. Above the zero-rate bracket, the U.S. PIT currently has rate brackets of 10%, 15%, 25%, 28%, 33%, and 35%. The U.S. CIT generally has rate brackets of 15%, 25%, 34%, and 35%.

### E. Global vs. Schedular Taxation

In general, income tax compliance and enforcement is facilitated by a "global" structure in which all categories of income are determined in the same way and subject to the same rate structure. Global taxation minimizes administrative problems caused by taxpayer efforts to categorize their income in one way or another. Global taxation also promotes efficiency (by making the tax system neutral with respect to different income-producing activities) and fairness (by treating a dollar of income the same from an ability-to-pay standpoint, no matter how the income is earned).

As an administrative matter, it may be desirable to use different tax collection methods with respect to certain categories of income (such as tax withholding only on wage and salary income). Technically, these differences violate pure global taxation. But the deviation from global

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68 I.R.C. §§ 24(a) (child tax credit), 151(c), & 152 (dependency exemption).
70 I.R.C. § 3101.
72 I.R.C. § 11(b).
taxation is exacerbated under a “schedular” system in which categories of income are determined differently and subjected to different tax rates. If, for example, two categories of income have separate, progressive rate schedules, taxpayers may be able to split their income between the categories and gain the benefit of both sets of low-rate brackets. Schedular systems may also limit or prohibit the netting of offsetting items appearing on different schedules; this results in possible mismeasurement of income and ability to pay.

One increasingly common deviation from global taxation is separate treatment of labor and capital income. The greater mobility of capital income than labor income may justify some preferential tax treatment of the former. But any distinction between labor and capital income creates potential inefficiency and unfairness, and generates administrative problems in differentiating between the two. For example, for several years, the United States has struggled with determining the proper tax treatment of “carried interests” held by managers of certain investment funds. The policy question is whether (and to what extent) the consideration received by the managers represents compensation for their services (a form of high-taxed labor income) or a return on their capital investment (a form of preferentially-taxed capital income). Thus far, there has been no legislative resolution of this difficult problem. Any further deviations from global tax principles, such as different taxation of different categories of labor or capital income, would likely create additional administrative difficulties, inefficiencies, and unfairness.

The U.S. experience in this area is mixed. The United States nominally has a global system in which all income is taxed alike. But the exceptions to this general rule are so plentiful that the end result is a system with some resemblance to a schedular system. Among the major categories of income that are taxed differently from “ordinary” income are (1) certain types of capital income, such as capital gains and dividends, (2) certain active business income earned outside the United States, (3) manufacturing

73 See, e.g., AULT & ARNOLD, supra note 24, at 48–49, 72, 151 (France, Germany, and the United Kingdom).
75 I.R.C. § 61.
76 I.R.C. §§ 1(h), 1211.
77 In general, income earned by a foreign person, including a wholly-owned foreign subsidiary of a U.S. parent corporation, is not subject to tax in the United States unless it is effectively connected with the conduct of a U.S. trade or business or constitutes certain types
income,\textsuperscript{78} and (4) income and losses from so-called "passive" activities.\textsuperscript{79}

\textit{F. Principles of Symmetry and Inclusiveness}

In addition to simplicity, equity, and efficiency, two additional tax policy principles that may help with tax administration are "symmetry" and "inclusiveness." The symmetry principle argues for comparable treatment of income and loss. A loss is simply a negative amount of income; thus, income and losses should be treated symmetrically in a tax system to achieve a proper measurement and taxation of \textit{net} income. Moreover, when losses are not treated symmetrically with income, taxpayers devote much tax planning to overcome the disparity, and tax administrators are burdened with determining the validity of the plans.

The U.S. experience with this issue is again quite mixed. The United States nominally allows a deduction for losses in the same manner that it requires the inclusion of income.\textsuperscript{80} But due to concerns about artificial (tax shelter) losses, the "cherry-picking" problem permitted by the realization principle (which permits taxpayers to choose when to realize their losses and gains), and other policy objectives, the United States generally does not treat losses symmetrically with income. For example, taxpayers may liberally carry forward and (to a limited extent) carry back their net operating losses (in general, the excess of total deductions over gross income in a year),\textsuperscript{81} but are not provided with cash reimbursement for the tax value of such losses (in contrast to the tax treatment of net income). Since the amount of a loss carryforward is not indexed, the carryforward gradually loses its value to taxpayers. Taxpayers, therefore, engage in a range of strategies to avoid incurring tax losses if a carryback cannot be used. United States' law also restricts the deductibility of certain losses, such as capital losses and losses from passive activities,\textsuperscript{82} and these rules also create enforcement difficulties. Of course, balanced against these problems are those created by other aspects of the tax law that would cause administrative difficulties if losses could be deducted (or reimbursed).

\textsuperscript{78} I.R.C. §§ 199.
\textsuperscript{79} I.R.C. § 469.
\textsuperscript{80} I.R.C. § 165.
\textsuperscript{81} I.R.C. § 172.
\textsuperscript{82} I.R.C. §§ 469, 1211.

of U.S. source income. I.R.C. §§ 881(a), 882(a). An exception applies, and a U.S. parent corporation is taxed currently on the foreign-source income of its foreign subsidiary, if the subsidiary's income constitutes "subpart F income," which generally refers to nonactive business income. I.R.C. §§ 951–957. Thus, active business income earned by the subsidiary outside of the United States is generally not taxed by the United States as it is earned.
without restriction. United States’ law, for example, permits taxpayers in certain circumstances to create artificial tax losses in excess of their economic effect. As a result, current U.S. restrictions on the deductibility and recoupment of losses may ultimately reduce tax administration costs.

Under the “inclusiveness” principle, an item that is deductible by one taxpayer should be includible in the income of some other taxpayer. If followed, this principle potentially creates a tension between the two taxpayers that might simplify the task of the tax administrator (who could act as a neutral stakeholder between the two competing interests). More generally, the inclusiveness principle helps to preserve the integrity of the income tax base. The principle is not sufficient, however, to protect the income tax revenue base, since the two taxpayers may be in different tax situations. For example, if the payor is a high-bracket taxpayer and the payee is a low- or zero-bracket taxpayer, the amount of revenue collected by the government will vary, depending upon whether the payment is both deductible by the payor and includible in the payee’s income, or nondeductible by the payor and excludible from the payee’s income.

G. Taxation of Fringe Benefits

The taxation of noncash fringe benefits received by employees is a challenging issue for tax administrators. The theoretical case to tax such benefits is straightforward: taxation promotes both vertical and horizontal equity and eliminates the potential deadweight loss if benefits are untaxed and the subjective value of the benefit to the employee is less than the employer’s cost. But in practice, the taxation of such benefits is very difficult. The principal problem is determining the proper amount of income if the fair market value of the benefit cannot be easily ascertained. In addition, it may be difficult to distinguish a taxable benefit or privilege from a noncompensatory (and nontaxable) condition of employment. Finally, taxation of fringe benefits presents potential liquidity problems for the recipient of the benefit.

If the fringe benefit is a deductible item to the employer, then some of the problems with taxing the employee directly can be avoided by instead denying the deduction to the employer. This approach has the additional benefit of avoiding having to allocate the value of “group” fringe benefits among employees. For example, if an employer purchases a group health

83 The converse of this rule does not necessarily apply. For example, a consumption-type expense by one taxpayer, which would ordinarily be nondeductible under an income tax, may, nevertheless, represent income to the recipient of the expense.

insurance policy as a fringe benefit for its employees, it may be very
difficult to determine the fair market value of the benefit received by each
employee, given differences in employee age and health status. Denying the
employer’s deduction avoids this problem. Finally, such an approach
substitutes one taxpayer for many possible taxpayers, thereby simplifying
tax administration.

The deduction-denial approach, however, is not necessarily a complete
substitute for direct taxation of the employee. As noted, differences in the
tax situations of the employer and employee may mean that the two
approaches have different income tax effects. In addition, if the fringe
benefit would also be taxable for social insurance tax purposes, that
consequence would be lost with a deduction denial applicable only for
income tax purposes. More generally, the deduction-denial approach with
respect to certain fringe benefits means that cash and noncash compensation
are not taxed alike, and this discrepancy may create additional
administrative problems.

Yet another approach, tried in New Zealand, is to tax the employer
directly on the value of the employee’s fringe benefit (or the cost to the
employer). This approach potentially has greater flexibility than the
deduction-denial approach in the case of nontaxable employers, such as
governmental entities and charities, which would be unaffected
by loss of a
deduction. In other respects, however, this alternative would seem to have
the same general advantages and disadvantages as the denial of a deduction.

In dealing with the fringe benefit issue, the tax administrator should
disregard relatively small, de minimis, benefits. The United States explicitly
permits de minimis fringe benefits to be excluded from income, but also
allows several other categories of fringe benefits, which are generally of
limited value, to be excluded. For example, benefits for which the employer
incurs no substantial cost (including forgone revenue) are generally
excluded from income. For relatively small benefits, the advantage of
comprehensively taxing the employee’s income may be outweighed by the
administrative cost of trying to do so. For other larger benefits, the value of
which is taxable, the administrator may wish to provide formulas and other
rules of thumb to simplify the taxpayer’s task of complying with the law.
The IRS, for example, provides several different rules and formulas for
determining the fair market value of employer-provided automobiles,

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86 I.R.C. § 132(a)(4), (e).
87 I.R.C. § 132(a)(1), (b). In addition, within limits, employee discounts are excluded.
I.R.C. § 132(a)(2), (c).
aircraft, meals, and other benefits. Finally, although the problem may be avoidable in the fringe benefit area, tax rules should generally be crafted wherever possible to avoid reliance on inherently hard-to-determine facts for both the taxpayer and administrator. For example, the United States permits taxpayers in certain circumstances to deduct the fair market value of property donated to a charity. This rule is generally contrary to sound tax policy principles and, more importantly, invites valuation disputes and administrative difficulties that could be avoided if the deduction were limited to the taxpayer’s basis in the property.

H. Income Taxation of Enterprises

As previously noted, the income tax treatment of enterprises must be coordinated with the PIT because of the possibility of taxpayers being able to shift or divide their income-producing activities between the two systems. The threshold question for enterprise taxation is whether the enterprise should be treated as a separate entity for tax purposes or as a “pass-through” in which all of its tax items are passed through the entity and allocated to its owners. Pass-through taxation is more consistent with global taxation since it generally treats a taxpayer’s income from a business enterprise in the same manner as any other income. The main problem with pass-through taxation is determining the allocation of the enterprise’s tax items. In order to prevent purely tax-motivated allocations that take advantage of tax differences among the owners, it is generally sensible to try to require matching between the allocation allowed for tax purposes and the actual division of economic benefits and burdens by the owners. This objective becomes very difficult to achieve if the economic sharing of items is complicated.

Separate entity taxation is a form of schedular taxation because it generally taxes a taxpayer’s income from a business entity differently from other income. Tax discrepancies can be reduced by conforming as much as possible the entity’s applicable tax rate and method of computing taxable income to the provisions of the PIT. A further issue is the tax treatment of distributions from the entity to the owners, and whether there will be any double taxation of the income of the entity.

If both pass-through and separate entity taxation of businesses are permitted, an additional question involves the dividing line between the two

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88 Treas. Reg. § 1.61-21.
89 Cf I.R.C. § 170(e)(1) (reducing the allowable deduction to an amount less than fair market value in certain circumstances).
approaches. In the ideal, the line should be drawn along an inelastic margin to reduce opportunistic behavior by taxpayers.

The United States generally requires incorporated enterprises to be treated as separate entities for income tax purposes unless the corporation qualifies for, and elects, status as a pass-through entity (classified as an "S corporation"). The main eligibility requirement for an S corporation is a straightforward financial structure that simplifies the allocation of tax items. Unincorporated enterprises, including most partnerships and limited liability companies, are generally permitted to elect their treatment as separate or pass-through entities for income tax purposes. Enterprises with public owners are generally treated as separate entities. Finally, distributions from separate entities are generally taxed, but distributions treated as dividends (as well as capital gains) are taxed preferentially to mitigate the effect of double taxation.

I. Centralization and Decentralization of Tax Administration

Because of China’s generally decentralized administration of the PIT, this article ends with a few observations regarding the potential advantages and disadvantages of decentralization. A decentralized system potentially allows increased specialization or tailoring of tax rules to local needs and preferences, easier linkage of the tax liability obligation to the benefits of taxation, increased accountability of tax administration officials, and greater empowerment of citizens over taxation choices. In each of these respects, it is possible that a decentralized system will be more successful than a more centralized system in facilitating development of a positive tax culture.

The principal disadvantage of decentralization is the cost of coordination, to the extent uniformity in the law and its application is desirable. For example, taxpayers may object if a national law is applied differently to two taxpayers in two different local jurisdictions. Indeed, such a reality (or its mere perception) may detract from a sense by taxpayers that they play equal roles in a common, national tax system. More generally, nonuniform application of the law may violate the law’s policy goals of efficiency and equity. Decentralization may also result in undesirable tax competition between jurisdictions, and a “race to the bottom,” as jurisdictions attempt to externalize their tax liabilities to other jurisdictions. Decentralization may present difficult jurisdictional questions in the case of

91 I.R.C. § 1361.
92 I.R.C. § 1361(b)(1)(D) (setting forth one class of stock rule).
93 Treas. Reg. § 301.7701-1.
94 I.R.C. § 7704.
95 I.R.C. § 1(h).
taxpayers who reside in one locality but earn income in another. Finally, decentralization may provide localities with incentives to shirk paying their full share of "tax infrastructure" costs incurred by the national government for the benefit of all jurisdictions.

The United States has a federal system in which the States have sovereign power to impose their own taxes separate from the federal government. When they do so, the State or locality generally is responsible for the tax administration. States that impose income taxes often conform their systems, in whole or in part, to the federal system (a process known as "piggybacking"), but when they do so, it is a matter of their choice (and generally adopted for cost-saving reasons). Moreover, States still administer their own income tax systems and generally do not participate in the administration of the federal system.

Since its enactment in 1913, the U.S. federal PIT has been administered by a federal agency, initially, the Bureau of Internal Revenue (BIR) and now by the IRS. In the early years of the PIT, the degree of centralization of the BIR's administration of the tax varied.\(^6\) During the mid-1990s, the IRS changed its administration from one organized along geographic lines to one generally organized based on the type and size of taxpayer.\(^7\) The reorganization recognized the common nature of problems encountered by different types of taxpayers, no matter where they are located in the country, and the advantages of uniformity in tax law administration. The IRS maintains many local offices around the country to carry out specific functions, but these offices ultimately report to the Commissioner of Internal Revenue and the Commissioner's top deputies, most of whom are part of the national office in Washington, DC. In 2010, when the U.S. population was about 311 million, the IRS employed about 94,000 employees to administer all federal taxes (not just the PIT). About half of the employees were engaged in "examinations and collections," the principal activities for tax law enforcement. The remaining employees were mainly engaged in providing education and assistance to taxpayers.\(^8\)

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\(^6\) For a description of the administration of the U.S. PIT prior to 1940, including changes in the size and centralized structure of the BIR, see Roy G. Blakey & Gladys C. Blakey, The Federal Income Tax 527–58 (1940). Dr. Thomas Sewall Adams, a professor of political economy at Yale and long-time advisor to the Treasury Department on tax policy and legislation, urged greater decentralization of tax administration during the early years of the U.S. PIT, with increased discretion granted to the tax authorities. See Thomas S. Adams, Should the Excess Profits Tax Be Repealed?, 35 Q. J. Econ. 363, 373–74 (1921).


IV. CONCLUSION

The modern U.S. PIT was enacted in 1913 following ratification of the Sixteenth Amendment to the U.S. Constitution.\(^{99}\) In its initial years, the PIT was very modest and affected only a small number of high-income households, constituting about two percent of all households.\(^{100}\) During the next twenty-five years, subsequent events, including the United States' involvement in World War I and the onset of the Great Depression, led to dramatic changes in certain aspects of the PIT as well as the corporate income tax. During certain periods, for example, the PIT was made steeply progressive, corporate income taxes were significantly increased, and a corporate excess-profits tax was enacted.\(^{101}\) Throughout the twenty-five-year period, however, the scope of the PIT did not change very much. For example, in 1918, although 15% of families paid some PIT, the wealthiest 1% of families paid 80% of the tax.\(^{102}\) By 1936, only 2 million out of 32 million U.S. households — about 6% — paid any PIT.\(^{103}\) As illustrated by Figure 1, it was not until World War II that the PIT began to affect a broad segment of the population.\(^{104}\) Between 1939 and 1945, the number of individual income tax returns filed increased from about 8 million to 50 million, and almost 90% of the labor force filed tax returns (and 60% paid tax) by the end of the War.\(^{105}\)

History has shown that as countries develop economically, they place greater reliance upon the PIT as a revenue source. The PIT is potentially attractive because of its capacity for raising revenue in a countercyclical way, and to achieve redistribution. In addition, economic development helps to provide the societal institutions necessary for effective administration and enforcement of a PIT. According to OECD data, over the last forty-five years, the PIT of OECD countries has generally averaged between 25% and 30% of total tax revenues.\(^{106}\) The United States, which

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\(^{99}\) The first U.S. PIT was enacted during the Civil War and lasted one decade. A second PIT was in effect briefly in 1894–95.

\(^{100}\) See Brownlee, supra note 1, at 54, 56–57; Witte, supra note 1, at 78. The Appendix contains data showing the approximate scope of the U.S. PIT between 1913 and 1947.

\(^{101}\) See Brownlee, supra note 1, at 58–106; Witte, supra note 1, at 79–109.

\(^{102}\) See Brownlee, supra note 1, at 63.

\(^{103}\) Id. at 87.

\(^{104}\) See also infra Appendix p. 411, Figure A-1.


\(^{106}\) In this OECD data, total tax revenue includes state and local taxes and PIT revenue includes state and local income taxes. OECD, Revenue Statistics — Comparative Tables,
has no VAT, is at the high end, with the PIT generally averaging between 35% and 40% of total revenues. The PIT of the United Kingdom and Germany has generally averaged around 30% and 25% of each country’s total revenue, respectively. The PIT in all three countries has generally been between 9% and 10% of GDP, roughly the same as the percentage for all OECD countries.

China’s fast economic growth may require its PIT, now about thirty years old, to mature quickly (although, presumably, not as quickly as the expansion of the United States’ PIT during World War II). To assist the maturation process, this article has described the positive (and some less positive) experiences in the United States with administration of its PIT system.

APPENDIX

Figure A-1 illustrates one measure of the approximate scope of the modern U.S. PIT system between its enactment in 1913 and 1947. The figure represents the total number of individual income tax returns filed as a percentage of the total U.S. population in each of those years, and shows that, based on that measure, the U.S. PIT system affected less than seven percent of the population prior to 1940.107

FIGURE A-1: INDIVIDUAL INCOME TAX RETURNS AS PERCENT OF TOTAL POPULATION, 1913–1947

107 The data for Figure A-1 is derived from IRS STATISTICS OF INCOME, NINETEEN YEARS OF INDIVIDUAL INCOME AND TAX STATISTICS, 1916–2005 Table 1, http://www.irs.gov/taxstats/index.html, and 3 HISTORICAL STATISTICS OF THE UNITED STATES: EARLIEST TIMES TO THE PRESENT 3–25 (tbls.Ca9-19, col. Ca14) (Susan B. Carter et al., Millennial ed. 2006). Beginning in 1918, married couples were permitted to file joint returns in which their combined income and deductions were reported, and the number of individual income tax returns in Figure A-1 includes these joint returns. Until 1948, however, there was no tax advantage to filing a joint return, since the combined income amount was still subject to the same progressive rate schedule applicable to individual taxpayers. Thus, each person of a two-income-earner couple was generally encouraged to file as a separate taxpayer rather than to join in a joint return. Therefore, Figure A-1 treats each joint return through 1947 as indicative that only one person was affected by the PIT.