

# Tax Elections as Screens

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*Information asymmetry between the government and taxpayers is a fundamental challenge of the income tax. This article complicates the consensus view that elective provisions in the tax law are necessary evils by proposing a novel account of statute-based tax choices ("tax elections") as informational screens. To illustrate the mechanics of screening, this article describes a fictional tax election that perfectly separates taxpayers of one type (honest compliers) from taxpayers of the second type (dishonest evaders). Building on this illustration, the author applies the theory of screening to the most common tax election in the United States tax context: the election to itemize one's tax-deductible expenses. A taxpayer's choice to itemize can help reveal important taxpayer attributes, particularly when analyzed alongside other available tax return data. These attributes include the taxpayer's earning ability, responsiveness to taxes and propensity to voluntarily comply with the tax law. However, screening benefits are not blanket justifications for the use of tax elections. The article concludes by contextualizing the screening account within a broader cost-benefit approach to evaluating tax elections. Screening benefits must be estimated and weighed against the complexity costs of offering a particular election. In addition, the policy and distributional objectives accomplished or offended by the election must also be taken into account. Even if many status quo tax elections might not survive this broader cost-benefit scrutiny, screening offers a previously unrecognized silver lining. With screening, the government can harvest distribution-neutral efficiency gains from our current (imperfect) system.*

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## Introduction

### I. The Screening Conversation in Law and Economics

A. *Economics Literature on Screening and Tagging*

B. *Legal Literature*

(i) Tax Elections

(ii) Screening

### II. A Hypothetical Screening Tax Election: Evaluating Costs as Well as Benefits

A. *The Hypothetical Simplified Cash Amount Elections*

(i) Screening Setup I: Without Compliance Costs

(ii) Screening Setup II: With Compliance Costs

B. *A Cost-Benefit Approach to Tax Elections*

(i) Screening Benefit

(ii) Policy Purpose Benefit

(iii) Compliance Costs for Taxpayers

(iv) Costs for the Government

(v) Putting It All Together: A Cost-Benefit Rubric

### III. Itemizing as Screening

A. *The Election to Itemize*

B. *Itemizing as Screening*

C. *The Policy-Relevant Characteristics Revealed by the Election to Itemize*

(i) Cost of Itemizing as a Tag for Taxpayer Earning Ability

(ii) Cost of Itemizing as Linked to Responsiveness to Taxation

(iii) Cost of Itemizing as Linked to Taxpayer Compliance Posture

(iv) Cost-Benefit Analysis of the Election to Itemize

## Conclusion

## Introduction

Tax elections—or statutory provisions that offer taxpayers the ability to choose among two or more tax treatments for a single transaction or taxable event—are prominent features of developed countries’ income tax systems.<sup>1</sup> The *Internal Revenue Code (IRC)*<sup>2</sup> of the United States has over three hundred explicit income tax elections,<sup>3</sup> and there are over two hundred tax elections in

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1. While this article focuses on tax statute-based (explicit) tax elections, there are clear parallels to implicit tax elections achieved through tax planning or transactional substitutions (workaround transactions) that taxpayers can execute to access preferential tax treatment. See Tim Edgar, “Building a Better GAAR” (2008) 27:4 Va Tax Rev 833.

2. *IRC* (2016).

3. See Heather M Field, “Choosing Tax: Explicit Elections as an Element of Design in the Federal Income Tax System” (2010) 47:1 Harv J on Legis 21 at 24–25 (discussing ways in which tax elections increase complexity for taxpayers and the government) [Field, “Choosing Tax”].

the Canadian *Income Tax Act*.<sup>4</sup> In recent years, a new scholarly literature on tax elections has burgeoned and reached a loose consensus that, in most cases, tax elections are necessary evils: statutory mechanisms that are justified by the unfortunate combination of intractably complex tax laws and irrepressibly adaptive taxpayer avoidance strategies.<sup>5</sup>

This article challenges the consensus view by offering an account of tax elections as screening devices that can be leveraged by tax administrators to improve the efficiency of the income tax system. Put simply, a screening device is a menu of choices put in place by a principal (such as a taxing authority)<sup>6</sup> that causes agents (such as taxpayers) who are required to make a choice from the menu to reveal private information to the principal. Legal scholars across doctrinal areas have increasingly recognized the potential of screening devices for resolving informational problems presented in a variety of public and private law settings.<sup>7</sup> Nowhere are screens more relevant than taxation.

The foundational problem of income tax—as confirmed by the rise of optimal taxation as the dominant analytical framework within public economics—is the information asymmetry that exists between the government and taxpayers.<sup>8</sup> Taxpayers are well-informed about their income-earning ability as well as the amount of income that they have earned during a given tax

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4. *Income Tax Act*, RSC 1985, c 1. See Ryan Keey et al, eds, *Canada Tax Service Elections Guide 2009* (Toronto: McCarthy Tétrault & Carswell, 2009) at iii.

5. See Emily Cauble, “Tax Elections: How to Live With Them if We Can’t Live Without Them” (2013) 53:2 Santa Clara L Rev 421. Cauble notes that “a sophisticated, well-advised taxpayer generally will have no reason to do anything other than make the most advantageous election possible. Consequently, only unsophisticated taxpayers who do not obtain adequate advice will forgo the potential tax benefits of an election. As a result, tax elections produce unfairness.” *Ibid* at 424. See also Field, “Choosing Tax”, *supra* note 3 at 27–30; Ritva Immonen et al, “Tagging and Taxing: The Optimal Use of Categorical and Income Information in Designing Tax/Transfer Schemes” (1998) 65:258 *Economica* 179; N Gregory Mankiw & Matthew Weinzierl, “The Optimal Taxation of Height: A Case Study of Utilitarian Income Redistribution” (2010) 2:1 *American Economic J: Economic Policy* 155; Michael Keen, “Needs and Targeting” (1992) 102:410 *Economic J* 67; H David Rosenbloom, “Banes of an Income Tax: Legal Fictions, Elections, Hypothetical Determinations, Related Party Debt” (2004) 26:1 *Sydney L Rev* 17.

6. Note that the principal in this asymmetrical information set-up could be any sort of principal, including, but not limited to, a government, an employer, a firm offering goods for sale, a securities regulator, etc.

7. See Part I, *below*.

8. Information is pivotal to the model of optimal taxation pioneered by Sir James Mirrlees. It starts from the premise that the government lacks information about taxpayers’ earning abilities, but taxpayers know their abilities. See James Mirrlees, “An Exploration in the Theory

period. However, the government lacks virtually all information about the former and, particularly where cash income or non-third-party reported income is involved, possesses scant reliable information about the latter. Left with few other options, the government must look to the best available (but still highly imperfect) proxy: a taxpayers' annual income as self-reported for tax purposes. However, a tax instrument that looks to self-reported income as the base on which tax is assessed generates myriad social costs. It reduces the returns to work effort as compared to the returns from untaxed leisure, it taxes the returns to savings and investment while leaving current consumption unburdened, and it creates incentives to under-report one's income. In light of the problems posed by the government's paucity of information about taxpayers, screening offers a particularly compelling model for understanding the legal design choices embodied in existing tax elections. Accordingly, this article highlights the potential for well-designed tax elections to play a supporting role in our highly imperfect income tax system by revealing valuable but otherwise unobservable information about taxpayers to the government.<sup>9</sup>

I make this argument in two Parts. In Part II, I construct an explanatory hypothetical tax election that, as a mechanical matter, causes taxpayers of one type (honest compliers) to reveal themselves by making the election while taxpayers of the second type (dishonest evaders) stick with the default treatment. The hypothetical election thus perfectly separates taxpayers and reveals important traits to the government. Further, I show that where the costs of imposing the screen on taxpayers are outweighed by the benefits of taxpayer sorting, a tax election will be socially beneficial.<sup>10</sup>

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of Optimum Income Taxation" (1971) 38:2 Rev Economic Studies 175. The problem addressed by the theory of optimal taxation is informational, and the solution offered by optimal taxation is screening. See Andrew T Hayashi, "The Legal Salience of Taxation" (2014) 81:4 U Chicago L Rev 1143, citing David A Weisbach, "Toward a New Approach to Disability Law" [2009] 47 U Chicago Legal F 74. See also Leigh Osofsky, "Who's Naughty and Who's Nice?: Frictions, Screening, and Tax Law Design" (2013) 61:5 Buff L Rev 1057 at 1074–081 (emphasizing the centrality of information to optimal tax screening solutions).

9. Public economics begins with the premise that there is a trade-off between equity and efficiency—the more redistribution we achieve or the more equal people are made on an after-tax basis—the greater the losses from behavioural distortions, such as substitutions between labour and leisure. See Louis Kaplow, *The Theory of Taxation and Public Economics* (Princeton, NJ: Princeton University Press, 2008) at 392–401 [Kaplow, *Theory*]. I do not disturb this premise, but suggest status quo tax elections have a previously unrecognized potential to tailor tax burdens as well as benefits.

10. This article's descriptive account of tax elections as screens should not be interpreted as

In Part III, I apply the theory of screening to what is arguably the most commonly encountered election in the US income tax environment—the election to itemize deductible expenses under IRC section 63(e).<sup>11</sup> I then explore some private taxpayer attributes that might be revealed by a taxpayer’s affirmative choice to itemize: responsiveness to the burdens of taxation, income-earning ability, and honesty in self-assessment of income and allowable deductions.

The intuition of how a screening election can improve efficiency by revealing information about taxpayers to the government requires some explanation. In the context of taxation, as well as in other markets, asymmetric information can produce market failures.<sup>12</sup> This means that one party cannot credibly gain private information about another party, and without this information (such as, classically, the quality of a used car), the uninformed party will be unwilling to enter into a trade.<sup>13</sup> In the income tax context, asymmetric information lies at the heart of nearly every interaction between the government and a taxpayer.<sup>14</sup> Taxpayers—but not the government—generally know their own sources of and magnitudes of income, and they are aware of their own personal attributes

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a generalized defence of the status quo hodgepodge of tax elections in the United States or in Canada. Proposals for fundamental tax reform must take into account all aspects of the tax code, including tax elections that may have undesirable distributional and base-narrowing effects. See Part II, *below*. In the interim, however, harnessing the information revealed by tax elections, including the election to itemize, has the potential to improve the efficiency of our status quo tax system without reducing equity.

11. *Supra* note 2, § 63(e).

12. See Joseph E Stiglitz, “The Theory of ‘Screening,’ Education, and the Distribution of Income” (1975) 65:3 *Am Econ Rev* 283 at 283–300 (for formal background on screening). In my translation of Stiglitz’ one-sided private information model to the government-taxpayer setting, the qualities at issue are characteristics of taxpayers that are relevant to tax policy-makers, such as one’s propensity to evade taxation, ability to earn income and behavioural responsiveness to changes in marginal tax rates.

13. George Akerlof’s “lemons” model offers a setting in which used car buyers cannot identify lemons and as a result opt out of the market for cars altogether. See George A Akerlof, “The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism” (1970) 84:3 *Q J Economics* 488 at 490–91 [Akerlof, “Lemons”] (demonstrating formally how asymmetric information can cause market unraveling in the absence of devices like screens and signals).

14. See Mirrlees, *supra* note 8. Mirrlees revolutionized the study of taxation by positing the tax schedule as creating labour market incentive compatibility constraints that need to be satisfied to minimize, if not eliminate, deadweight loss. *Ibid*. See also Kaplow, *Theory, supra* note 9 at 53–79; Robin Boadway, *From Optimal Tax Theory to Tax Policy: Retrospective and Prospective Views* (Cambridge, Mass: MIT Press, 2012) at 7–16.

that are relevant to tax. For instance, a taxpayer may be more or less attracted to—or repelled by—tax filing, she may be more or less willing to spend time on tax preparation, she may be more or less risk averse in terms of taking aggressive tax positions, and she may have positive or negative attitudes towards supporting various government services through income taxes. If the government had automatic access to details about these personal attributes and sources of income of a given taxpayer, it would not need to require taxpayers to file returns or take any self-assessment action whatsoever—a tax bill or refund would simply arrive in the taxpayer’s mailbox. But because information asymmetries loom large, the government must find ways to elicit truthful disclosure from taxpayers. Third-party reporting by employers, payers of interest or investment returns, and other reporting requirements play important roles in this regard. The core contribution of this article is to identify explicit tax elections as an overlooked arrow in the government’s quiver for collecting valuable (tax-relevant) private information from taxpayers.<sup>15</sup>

In the case of a taxpayer’s election to itemize, what useful information is generated for the government? I identify three categories of insights that may be revealed by the election to itemize and elaborate briefly on each: the taxpayer’s neediness or qualification for targeted subsidies, the taxpayer’s responsiveness to taxation, and the extent to which the taxpayer is compliance-oriented versus a tax gamer.

First, itemization behaviour is plausibly linked to psychological traits that carry strong predictions about earning ability. Indicators of earning ability open the door to a variety of ways of tailoring the income tax system to raise revenues from taxation with less distortion of productive activity.

Second, a taxpayer’s choice to itemize, and how much she chooses to itemize, can reveal information about how responsive she is to taxation. Imagine two taxpayers who are nearly identical for tax purposes. They have similar magnitudes of earnings as well as expenses that are eligible for itemized deduction. Suppose that each taxpayer’s itemizable expenses exceed the standard deduction by a modest amount, but that when filing her annual return the first taxpayer chooses to itemize while the second chooses to take the standard deduction. One way of viewing this is that rather than jotting

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15. See Andreu Mas-Colell, Michael D Whinston & Jerry R Green, *Microeconomic Theory* (New York: Oxford University Press, 1995) at 460–66 (for another explanation of how screens can work to separate taxpayers according to their exogenously determined opportunity costs, which are often modeled as a taxpayer’s intrinsic marginal product or wage rate).

down ballpark estimates or fabricating records, the second taxpayer opted to leave “money on the table”. This is likely to reveal something about how sensitive the taxpayer is to tax rates and to opportunities to reduce her tax.

Third, as in the hypothetical “simplified cash amount” election, itemizing choices can reveal information about taxpayers’ compliance postures. This is true particularly where itemization is taken into account as one among many data points about a particular taxpayer over time. These sorts of taxpayer-specific inferences permit the tax agency to better tailor its audit determinations beyond the one-size-fits-all computer-generated “DIF scores” (based on the Discriminant Index Function scoring rubric) that are currently used in the US to select returns for audit.<sup>16</sup>

The key practical selling points of the screening theory of tax elections are its simplicity and availability. Taxpayers’ elective decisions are already tracked by the government.<sup>17</sup> Therefore, concerns about privacy encroachments and the costs of collecting additional data are unlikely to be serious. Moreover, no legislative or regulatory action is required. Viewing existing tax elections as screens therefore represents low-hanging informational fruit for the government.

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16. See US, Internal Revenue Service, *The Examination (Audit) Process*, IRS Fact Sheet FS-2006-10 (January 2006), online: <[https://www.irs.gov/uac/The-Examination-\(Audit\)-Process](https://www.irs.gov/uac/The-Examination-(Audit)-Process)> (for an overview of the discriminant function system (DIF) approach to flagging returns for audit).

17. For privacy advocates, this story about screening may raise concerns about the extent to which the government can data mine private information about taxpayers. The government and taxing authorities are constrained by statute in most jurisdictions regarding what kinds of information they can gather about taxpayers. But, in general, information gleaned from tax forms is fair game and so is publicly available information, such as that available through satellite images like those gathered by Google Earth. See generally Sam Dunn, “Now the Taxman is Spying on Your Home Using Google Earth: Satellite Images Give Clues About Wealth and Lifestyle That May Show You’re Not Paying Enough”, *The Daily Mail* (9 November 2013), online: <[www.dailymail.co.uk](http://www.dailymail.co.uk)>. Dunn describes Her Majesty’s Revenue & Customs (HMRC) use of satellite images to go after underreporting taxpayers in Britain to target

the hidden economy—customers not paying VAT on home repairs, for example—[this] cost the UK taxpayer £9billion a year. HMRC has spent nearly £1billion over the past three years trying to enforce the rules. Over the past 18 months, it has set up dozens of taskforces to probe the tax receipts and business practices of industries as diverse as restaurants, private cab firms, hairdressers, outdoor markets, car dealerships and even Avon Ladies.

*Ibid.*

The article proceeds as follows. Part I briefly discusses some of the key literature in both law and economics that relates to the screening thesis. Part II introduces the tax election screening theory with reference to a very simple hypothetical tax election called the “simplified cash amount” election and walks through a cost-benefit analysis of the election. Part III applies the screening model and the cost-benefit discussion to the election to itemize, with particular attention to the ways in which the information produced by the screen can be valuable to the government. The final section briefly summarizes and concludes.

## **I. The Screening Conversation in Law and Economics**

The idea that tax elections can work as costly screening devices is related to a number of literatures. In this section, I note the literature from economics that I borrow from to make my argument and try to contextualize how my thesis builds on a new and vibrant conversation in the legal literature on tax elections and choices in the law more generally.

### *A. Economics Literature on Screening and Tagging*

In the economics literature, screening is a mechanism for resolving problems of asymmetric information. Neoclassical models assume that all agents have perfect information about all relevant characteristics of the market in which they are operating. Where this is not the case, Pareto-improving trades can fail to occur.<sup>18</sup> The mechanism of screening was formalized by Joseph Stiglitz<sup>19</sup> and has been harnessed in modified settings by a number of

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18. See Akerlof, “Lemons”, *supra* note 13 at 491 (noting with respect to market unraveling the paradox of asymmetric information—at a price of X no one buys used cars, even though there are buyers in the market who have a value greater than X). See also Mas-Colell, Whinston & Green, *supra* note 15 at 437–50.

19. See Stiglitz, *supra* note 12. Stiglitz identifies one of the “social benefits of screening” as tailoring workers’ wages to their marginal products of labour, that is, allowing prices for labour to be set efficiently by setting cost of labour (wages) equal to benefit conferred by labour (marginal product). In the “normal” situation, where firms cannot directly observe workers’ marginal products of labour, firms will pay each worker the average expected marginal product of all workers (or their guess of the average). This creates what Stiglitz calls an “information wage tax”: “Imperfect information acts just like a wage tax on the more able, a wage subsidy on the less able.



economists studying legal institutions.<sup>20</sup> In the public economics context, the framing of the problem of government as lacking information about taxpayers is consistent with the optimal tax approach of Sir James Mirrlees.<sup>21</sup>

Another related strand of literature is that of “ordeal mechanisms” as screens. While not specific to income tax ordeals, this theory suggests that the costs of obtaining some elective benefit (such as welfare payments) may influence how those benefits end up being distributed across agents.<sup>22</sup> The idea is that only those taxpayers facing low opportunity costs of going through an ordeal that is necessary to obtain a certain benefit will avail themselves of the benefit.<sup>23</sup> Where heterogeneous agents face a costly ordeal such as the necessity of walking to a government bureau office to register for an income support program, the ordeal can act to separate agents with high opportunity costs to hurdling the ordeal from those with low opportunity costs of doing so.<sup>24</sup>

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Like all taxes, the ‘information wage tax’ is distortionary in its effect on the consumption-leisure decision. If screening costs are small enough, so long as labor is elastically supplied, everyone can be made better off as a result of screening.” *Ibid* at 287. In Stiglitz’ model, each worker knows his ability type, firms cannot observe ability types of workers and the cost of hurdling the screen is the same for all types. Even with this assumption—equal costs for high and low types of hurdling the screen—social welfare can be increased with screening. Note that my tax elections screening set-up has a different assumption—low types and high types are stipulated to have different costs of hurdling the screen.

20. See Jennifer F Reinganum, “Plea Bargaining and Prosecutorial Discretion” (1988) 78:4 *Am Econ Rev* 713; David Bjerk, “Guilt Shall Not Escape or Innocence Suffer?: The Limits of Plea Bargaining When Defendant Guilt is Uncertain” (2007) 9:2 *Am L & Econ Rev* 305 (refining Reinganum’s model to account for endogenous jury beliefs and behavior).

21. See Mirrlees, *supra* note 8. The information asymmetry between government and taxpayers (each taxpayer knows her exogenous earning ability, but the government does not) is at the root of the optimal taxation literature. *Ibid*.

22. See D Nichols, E Smolensky & TN Tideman, “Discrimination by Waiting Time in Merit Goods” (1971) 61:3 *Am Econ Rev* 312; Saurabh Bhargava & Dayanand Manoli, “Psychological Frictions and the Incomplete Take-Up of Social Benefits: Evidence from an IRS Field Experiment” (2015) 105:11 *Am Econ Rev* 3489 (discussing incomplete takeup literature with application to the tax context).

23. See Albert L Nichols & Richard J Zeckhauser, “Targeting Transfers Through Restrictions on Recipients” (1982) 72:2 *Am Econ Rev* 372. See also Tomer Blumkin, Yoram Margalioth & Efraim Sadka, “The Role of Stigma in the Design of Welfare Programs” (2008) CESifo Working Paper No 2305, online: <[www.cesifo-group.de/portal/pls/portal/IPORTAL.wwpob\\_page.show?\\_docname=1023395.PDF](http://www.cesifo-group.de/portal/pls/portal/IPORTAL.wwpob_page.show?_docname=1023395.PDF)>.

24. See Vivi Alatas et al, “Ordeal Mechanisms in Targeting: Theory and Evidence from a Field Experiment in Indonesia” (2013) Harvard Kennedy School Working Paper No 254, online: <[scholar.harvard.edu/files/remahanna/files/ordeal\\_mechanisms.pdf](http://scholar.harvard.edu/files/remahanna/files/ordeal_mechanisms.pdf)>.

Screens use costs to sort taxpayers, but this is only the first part of the story. For this sorting to be of any practical help to the government, the attributes revealed by the sorting must be relevant. For instance, if the attribute revealed by a given tax election is that honest taxpayers elect and dishonest taxpayers do not, then the separation achieved by the screen can be said to “tag” taxpayers.<sup>25</sup> Tagging occurs where the information yielded by the screen can be used by the government to tailor the burden or benefit of the tax system in a way that improves overall welfare.<sup>26</sup> Scholars have considered tagging in a variety of contexts: tagging by taxpayer need (i.e., very low income taxpayers), earning ability, height and blindness.<sup>27</sup> Tagging can also be used to adjust the marginal rate schedule to incentivize and raise revenue from high earning-ability taxpayers, consistent with the optimal tax model.<sup>28</sup>

## B. *Legal Literature*

### (i) Tax Elections

The proliferation of tax elections has sparked a new literature in tax law about the different roles played by explicit tax elections.<sup>29</sup> Alongside the descriptive conversation about tax elections there has also emerged a normative conversation about tax elections. There is substantial work showing that tax

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25. See George A Akerlof, “The Economics of ‘Tagging’ as Applied to the Optimal Income Tax, Welfare Programs, and Manpower Planning” (1978) 68:1 *Am Econ Rev* 8 (pointing out that efficiency gains from the tagging of taxpayers rests on the strength of the tag—the assumption that the tagged population “contains all the poor [or otherwise targeted] people and that this group contains only a fraction  $\beta$  of the total population” at 9).

26. See Matthew Weinzierl, “The Promise of Positive Optimal Taxation: Normative Diversity and a Role for Equal Sacrifice” (2014) 118 *J Public Economics* 128.

27. See e.g. Immonen et al, *supra* note 5. See also Mankiw & Weinzierl, *supra* note 5; Keen, *supra* note 5.

28. See Avraham Ebenstein & Kevin Stange, “Does Inconvenience Explain Low Take-up?: Evidence from Unemployment Insurance” (2010) 29:1 *J Policy Analysis & Management* 111.

29. Heather Field has suggested that there are limited circumstances in which tax elections can accomplish valuable policy goals, including using a taxpayer’s elective choice to reveal information to the government. See Field, “Choosing Tax”, *supra* note 3 at 63. In addition to Field, a handful of other scholars have considered how elections are used in the tax law. In particular, Steven A. Dean’s discussion of the 1998 check-the-box reforms demonstrates the manner in which electivity of tax treatment can increase, rather than reduce, tax complexity. See Steven A Dean, “Attractive Complexity: Tax Deregulation, the Check-the-Box Election, and the Future of Tax Simplification” (2005) 34:2 *Hofstra L Rev* 405. Others have given attention to specific elections as

elections can exacerbate complexity for taxpayers and the government.<sup>30</sup> Heather Field, in her broader analysis of the role of different types of tax elections, has documented the information-promoting role of tax elections, noting a number of instances in which tax elections help the government target eligible taxpayers with a particular tax treatment.<sup>31</sup> In addition to Alex Raskolnikov's proposal for a dual enforcement system discussed below, Yair Listokin and David Schizer have argued that offering choices to taxpayers about how their tax dollars are used can improve tax morale and the resilience of our voluntary compliance-based income tax system.<sup>32</sup> In the context of enforcement, Joseph Bankman and Clifford Nass advocate for the use of data-driven, interactive questioning as the next step in updating and improving the compliance environment.<sup>33</sup>

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well as the doctrinal aspects of tax elections. See Michael B Lang & Colleen A Khoury, *Federal Tax Elections* (New York: Warren, Gorham & Lamont, 1991) ch 2; Aubree L Helvey & Beth Stetson, "The Doctrine of Election" (2009) 62:2 *Tax Lawyer* 335; Victoria A Levin, "The Substantial Compliance Doctrine in Tax Law: Equity vs. Efficiency" (1993) 40:6 *UCLA L Rev* 1587; Edward Yorio, "The Revocability of Federal Tax Elections" (1976) 44:3 *Fordham L Rev* 463; John MacArthur Maguire & Philip Zimet, "Hobson's Choice and Similar Practices in Federal Taxation" (1935) 48:8 *Harv L Rev* 1281 at 1285–293.

30. See Cauble, *supra* note 5.

31. My analysis of tax elections as screens contributes to a literature that considers how taxpayer choices can allow taxing authorities to better tailor their interactions with taxpayers. Only over the past several years has a conversation begun that seeks to categorize tax elections according to their apparent purposes and to evaluate whether such purposes are properly served by the mechanism of an explicit election. Field notes that explicit tax elections can be useful to the government to target certain benefits towards qualifying taxpayers, such as taxpayers who claim a dependency exemption on their tax return (a de facto election) or make an *IRC* § 302(c)(2) election to waive the family attribution rules in cases where a redemption of stock might otherwise be treated as a sale rather than as a dividend. But, to the extent that this information is otherwise available to the government and the election provides what Field calls "a pure tax-planning opportunity", she concludes that such elections are hard to defend. See Field, "Choosing Tax", *supra* note 3 at 65.

32. See Yair Listokin & David M Schizer, "I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System" (2013) 66:2 *Tax L Rev* 179.

33. See Joseph Bankman, Clifford Nass & Joel B Slemrod, "Using the 'Smart Return' to Reduce Tax Evasion" (2013) *Stanford Public Law Working Paper No 2578432*, online: SSRN <<https://ssrn.com/abstract=2578432>> (discussing the double whammy of combining "data-driven interactive systems and data retrieval [which] increases the possibility of combining filing and audit functions" at 20).

(ii) Screening

A series of contributions outside tax have shown that choice-based legal rules can play a screening role to credibly reveal private information. The screening thesis has been explored in settings including choice of corporate domicile, whistle-blower statutes, plea bargaining and the use of preliminary injunctions, among others.<sup>34</sup>

With respect to tax, this article builds on prior analyses of tax rules as having an information-forcing component. Leigh Osofsky argues that provisions that deter tax planning should be analyzed as screens, demonstrating that legal frictions—contrary to the normative implications of screening theory—are often poorly targeted from a deterrence perspective.<sup>35</sup>

My hypothetical example in Part II is based on a proposal by Alex Raskolnikov to improve the government's ability to target audit and enforcement resources by presenting taxpayers with a choice between two tax enforcement regimes: a new, more co-operative regime versus the more traditional adversarial one. This choice can allow the government to screen

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34. See e.g. Edward M Iacobucci, "Toward a Signaling Explanation of the Private Choice of Corporate Law" (2004) 6:2 Am L & Econ Rev 319 (modeling firms' choice of corporate law as signaling private information about firm quality to investors); Anthony J Casey & Anthony Niblett, "Noise Reduction: The Screening Value of *Qui Tam*" (2014) 91:5 Wash U L Rev 1169; Reinganum, *supra* note 20; Bjerk, *supra* note 20. Other scholars channel this idea but do not focus on the tax election per se. In a comment on the article by David A Weisbach, "Formalism in the Tax Law" (1999) 66:3 U Chicago L Rev 860, Saul Levmore makes a connection between safe harbours and elective provisions as a response to the uncertainty that is generated by rules-based complexity, suggesting that only when taxpayers value certainty more than the amount by which the government would need to increase the tax rate to make such certainty revenue-neutral would a tax election be warranted. See Saul Levmore, "Double Blind Lawmaking and Other Comments on Formalism in the Tax Law" (1999) 66:3 U Chicago L Rev 915 at 916–17. See also Saul Levmore, "Taxes as Ballots" (1998) 65:2 U Chicago L Rev 387. Levmore's intriguing idea—that tax elections can and do communicate information that allows the government to "tailor" the tax system to well-calibrated taxpayer preferences—has not been explored in the context of elective tax provisions more generally. Finally, using choices as screens connects directly to the literature on default rules, including penalty defaults as information-forcing devices. See Ian Ayres & Robert Gertner, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" (1989) 99:1 Yale LJ 87.

35. See Osofsky, *supra* note 8 at 1098–100, 1104–111 (framing frictions in the tax code as screens to deter socially costly tax planning—specifically with respect to the IRC § 1091 wash sale rule and the § 125 health care flexible spending account use it or lose it rule).

taxpayers by their taxpaying motivations.<sup>36</sup> By structuring the regime choice such that co-operators benefit from choosing the co-operative regime and gamers benefit from choosing the adversarial regime, tax administrators will be better able to identify these very different (but otherwise indistinguishable) types of taxpayers.

With reference to implicit rather than explicit statute-based tax elections,<sup>37</sup> Benjamin Alarie has argued that “half-hearted”, anti-avoidance enforcement strategies of governments allow governments to price discriminate among taxpayers, thereby revealing taxpayers’ otherwise unobservable propensities to respond to changes in taxes.<sup>38</sup> However, a notable gap in this conversation about tax system design is how the theory of screening might be applied to statutory tax elections that exist in the status quo and how screening should fit together with concerns about tax elections and their complexity.

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36. See Alex Raskolnikov, “Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement” (2009) 109:4 Colum L Rev 689 at 712–13. Raskolnikov uses the notion of price discrimination—which is, for firms, a mechanism by which private information about consumers is revealed—to argue that the Internal Revenue Service can use an elective tax enforcement regime to tailor enforcement by separating gamers from everyone else; he argues that offering taxpayers a menu of options that will determine how any future taxpayer audits and litigation will be conducted—both procedurally and substantively—can result in a better, and more cost-effective, match between taxpayer types and enforcement strategies. *Ibid* at 707–10.

37. Following Field, implicit tax elections are tax choices offered by planning opportunities, in contrast to explicit elections that are offered by the tax statute itself. See Field, “Choosing Tax”, *supra* note 3.

38. See generally Benjamin Alarie, “Price Discrimination in Income Taxation” (30 January 2012) at 19, online: SSRN <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1796284](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1796284)> (arguing that the government can act as a second-degree price discriminator to help identify taxpayers that exhibit a high propensity to avoid taxes and, simultaneously, to tailor the de facto rate schedule that taxpayers face by reducing taxes for those taxpayers that are most likely to avoid or evade taxation). Readers should note that second-degree price discrimination parallels the one-sided private information framework in which I situate my itemization-as-screening model. See David Besanko & Ronald R Braeutigam, *Microeconomics*, 2nd ed (Hoboken, NJ: John Wiley & Sons, 2004) at 495–96 (for a precise definition and discussion of second-degree price discrimination, including the way in which it can generate information for firms about consumers’ willingness to pay for the good being traded).

## II. A Hypothetical Screening Tax Election: Evaluating Costs as Well as Benefits

To demonstrate how screening works in connection with tax elections, I present a hypothetical tax election that perfectly separates taxpayers on the basis of their compliance posture with regard to reporting cash income: honest taxpayers are induced to make the election, while dishonest taxpayers will prefer to stick with the status quo.

### *A. The Hypothetical Simplified Cash Amount Elections*

By way of background, readers are likely aware that the taxation of cash income is a key tax policy issue. The “tax gap” in the US is one statistic that helps quantify the importance of cash income, as it represents the Internal Revenue Service’s (IRS) estimate of the shortfall between taxes owed and taxes collected.<sup>39</sup> According to analysis by the IRS, a substantial part of the tax gap results from unreported cash income, including tips received by employees as well as cash income earned by self-employed taxpayers.<sup>40</sup>

Cash is hard for the government to tax because it is easy for a taxpayer to hide. Reporting requirements such as information reporting or withholding-at-source rules are generally impractical to enforce against cash income sources.<sup>41</sup> For taxpayers, income in the form of cash often does not “count” as taxable income.<sup>42</sup> Rather than copying a particular number from an official-looking form onto her tax return, the taxpayer must rely on her own records and

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39. The tax gap was a whopping \$385 billion in 2006, the latest year for which the statistic is available. See US, Internal Revenue Service, News Release, IR-2012-4 “IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study” (6 January 2012), online: <<https://www.irs.gov>>.

40. See Susan Cleary Morse, Stewart Karlinsky & Joseph Bankman, “Cash Businesses and Tax Evasion” (2009) 20:1 *Stan L & Pol’y Rev* 37 at 37. See also Bankman, Nass & Slemrod, *supra* note 33 at 3.

41. See Joseph Bankman, “Tax Enforcement: Tax Shelters, the Cash Economy, and Compliance Costs” (2005) 31:1 *Ohio NUL Rev* 1. An example of mandatory reporting requirements is the requirement that banks send customers statements of interest income, and they also forward these to the government (they are the “third-party” in third-party reporting). Another is the employer’s duty to remit a copy of a worker’s W-2 to the government.

42. See Bankman, Nass & Slemrod, *supra* note 33 (focusing on the cash sector as providing “a test case for the possible advantages of moving to a ‘smart return’” at 3–4).

memory to accurately report income from cash. Worse, Form 1040 is devoid of any direct references to “cash”. For the uninformed taxpayer, nothing immediately triggers concerns about reporting this category of income.<sup>43</sup>

(i) Screening Setup I: Without Compliance Costs

To illustrate mechanically how a hypothetical tax election can work as a screen, I substantially simplify the complex problem of tax compliance by making a series of assumptions. First, there are two distinct and mutually exclusive types of taxpayers in the world—honest and dishonest. Second, taxpayer types are pooled in the absence of the election, meaning that the government cannot differentiate the honest taxpayer type from the dishonest type. Third, there is only one moment for tax assessment—taxpayers file taxes once in their lifetime, not repeatedly over time.

Before continuing, some background about the two types of taxpayers is needed. The honest type seeks to accurately report all of her taxable income, regardless of its source. Even if she has income that is received in cash without any records or possibility of being reported to the government, such as income from odd jobs, tips or black market activities, she takes seriously her voluntary compliance obligations and is willing to expend energy to accurately report her cash income for tax purposes. On the other hand, the dishonest type does not gain utility (or avoid disutility) from being honest. She has no particular attachment to scrupulously declaring all of her income and will not invest in the effort necessary to accurately report her cash income unless she will face a sufficiently harsh sanction for not complying. What I am calling the “dishonest type” is really just *Homo economicus*: a rational utility-maximizing individual who seeks to minimize her taxes conditional on her beliefs about being audited and sanctioned for noncompliance.<sup>44</sup>

Both types of taxpayer have equal incomes on which they are required to pay taxes. Suppose that some portion of that income—suppose a flat dollar amount of \$100—is income from cash sources that would not

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43. See Internal Revenue Service, *Form 1040: US Individual Tax Return* (2015), online: <<https://www.irs.gov/pub/irs-pdf/f1040.pdf>>. However, “tips” are listed as a component of the category of wages on line 7.

44. See Gary S Becker, “Crime and Punishment: An Economic Approach” (1968) 76:2 *J Pol Econ* 169. In general, taxpayers in this situation have to pay penalties and back taxes (and may encounter other costly sanctions, such as managing the complexities of an audit or controversy litigation). I do not consider criminal sanctions for tax evasion here.

otherwise be observable to the government in the absence of an audit, and suppose an audit rate of  $1/3$  (33.33%). The marginal tax rate on this income is twenty-five percent (for both taxpayer types), yielding a tax bill of \$25.

Further suppose that there are costs embedded in the exercise of declaring one's cash income, and these costs are different for each of the two types of taxpayers. Suppose that for the honest type, the cost of estimating and reporting is \$10 ("estimation costs") but for the dishonest type it is zero. To help motivate this assumption, suppose that the higher cost of estimating and reporting cash income for the honest taxpayer reflects her greater attention to the details of the tax compliance exercise. For the dishonest taxpayer, the lower cost reflects her indifference to reporting cash for tax purposes.<sup>45</sup>

In addition, there are certain sanctions for not reporting income accurately, which I suppose are composed of two parts: fines (suppose an amount of \$25) and audit hassle (suppose also in the amount of \$25). For instance, if a taxpayer fails to declare the \$100 of cash income and she was audited, her total risk-adjusted liability would be \$25 (composed of \$25 of back taxes, \$25 dollars of fines, another \$25 of anxiety/hassle costs, adjusted by the probability of audit).

In this stylized setting, the simplified cash amount election itself is straightforward. All taxpayers can make an election to be treated as if they earned a threshold amount of income.<sup>46</sup> Like a safe harbour, the election will be presumptively respected unless there is sufficient evidence to the contrary (i.e., that the taxpayer earned more cash income than the threshold). For the

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45. The example could work equally well as a matter of mechanics if the costs were reversed and the parameters re-calibrated (e.g., if one assumed that the honest type bears the lower cost of estimating and reporting her income as compared to the dishonest type who incurs higher costs due to her distaste for such voluntary compliance activities).

46. The simplified cash amount election bears important similarities to some US states' approach to assessing "use tax" on the annual state income tax returns. A taxpayer owes use tax where there have been purchases made on which state-level sales tax should have been paid but were not paid to the state, such as sales-tax-free purchases over the internet. States often allow the taxpayer to use a proxy for the amount of use tax owed (such as an amount that is based on income) or to write down another amount, including zero, on their tax return. See Donald Bruce & William F Fox, *State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates* (September 2001), online: Center for Business and Economic Research <[cber.bus.utk.edu/ecom/ecom0901.pdf](http://cber.bus.utk.edu/ecom/ecom0901.pdf)>; Paul J Hartman, "Collection of the Use Tax on Out-of-State Mail-Order Sales" (1986) 39:4 Vand L Rev 993. See also Bankman, Nass & Slemrod, *supra* note 33 at 15–17, citing US, Research Department, Minnesota House of Representatives, *Use Tax Collection on Income Tax Returns in Other States*, by Nina Manzi (St Paul, Minn: Research Department, Minn HR, 2012) at 7, online: <[www.leg.state.mn.us/docs/2012/other/120453.pdf](http://www.leg.state.mn.us/docs/2012/other/120453.pdf)>.



purposes of this hypothetical, suppose the quantum of cash income specified by the election is \$110, which carries a tax liability of \$27.50. Subject to the assumptions and given information, the grid below shows the direct costs<sup>47</sup> to each type of taxpayer of the two available courses of action: elect or do not elect.

Taxpayer Type	Elect	Do Not Elect
Honest	\$27.50 = \$110 * 25% (elective amount * tax rate)	\$35 = \$10 (estimation costs) + \$100 * 25% (actual income * tax rate)
Dishonest	\$27.50 = \$110 * 25% (elective amount * tax rate)	\$25 = \$75 * 33.33% (back taxes and sanctions * audit probability)

Looking horizontally across the payoff grid, it is clear that the honest taxpayer will elect and the dishonest taxpayer will not (instead, she will simply report zero income and play the audit lottery). Taxpayer type is perfectly revealed by this election—there is no incentive for the dishonest type to masquerade as the honest type, and the honest taxpayer has no incentive to pose as a dishonest taxpayer.

Thus, in this stylized example, the election perfectly “solves” the government’s problem of figuring out which taxpayers are honest and which are dishonest.<sup>48</sup> Armed with this information, the government can pursue an enhanced enforcement strategy—it can avoid costly and fruitless audits of honest types while focusing its enforcement resources on dishonest taxpayers.

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47. Ignore for now the compliance costs that may be implicated by such an election (i.e., the deliberation costs that taxpayers must invest to decide whether or not to elect). See Emily Satterthwaite, “Taxing by Default” (2013) 59:2 McGill LJ 337 (defining deliberation costs in the tax election context). Note, however, that in this situation (unlike other real-world elections such as the election to itemize or to elect into S status for a state-level corporation) the cost of executing the election is minimal, because the election is executed simply by checking a box on the individual annual tax return.

48. It should be clear to readers that the result of this hypothetical screening election depends critically on the assumptions delineated above as well as the parameter values chosen in the example. First, changes in the parameter values can change the nature of the equilibrium. For instance, if the honest taxpayers’ costs of estimating and reporting her income from cash sources were lower (say, \$2 instead of \$10), her gains from electing the simplified cash amount would be reduced so much that it would no longer be cost-minimizing for her to make the election. She would be better off investing the necessary resources to estimate and report her actual cash income of \$100, rather than electing the \$110 simplified cash amount. Second, the result is sensitive to the magnitude of the simplified cash amount. This is important because, unlike taxpayer’s idiosyncratic costs of estimating and reporting their cash incomes, this parameter value

(ii) Screening Setup II: With Compliance Costs

So far, I have ignored the compliance costs—execution and deliberation costs to the taxpayer—that might be associated with the hypothetical simplified cash amount election. To embellish the set-up presented above in a more realistic direction, taxpayers' compliance costs—representing the different types of complexity that elections foist on taxpayers themselves<sup>49</sup>—are now incorporated into the payoff matrix.

Assume that adopting the hypothetical election increases complexity for all taxpayers on the first dimension of compliance costs: deliberation costs. This assumption is motivated by the following observation: choices can allow agents to optimize their outcomes (i.e., by choosing the tax-minimizing course of action), but this comes at the price of having to navigate the optimization process. In the case of the hypothetical simplified cash amount election, all taxpayers are confronted with the election on their tax returns. Each type must calculate two sets of tax positions: with the elective simplified cash amount and without it. Here, suppose that these deliberation costs reduce the payoff to each course of action (electing versus not electing) by \$5.

Suppose also that the hypothetical election increases complexity on the second dimension: the execution costs borne by taxpayers who choose to make the election. This is because the election is executed by attaching a separate schedule to the taxpayer's annual tax return—somewhat onerous because it requires a separate step and an additional form, but not terribly burdensome

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is controlled by policy-makers. If the government or the taxing authorities decide to set the elective simplified cash amount at, say \$145 instead of \$110, and all the other values in the example stayed the same, the results would change. The honest taxpayer would no longer find it advantageous to make the election—her tax liability on this amount would be \$36.25, which would exceed her tax liability plus her costs of reporting her actual cash income of \$100. Accordingly, the honest types would be indistinguishable from the dishonest types, creating a pooling equilibrium in which neither type makes the election. Conversely, if policy-makers set the simplified cash amount too low, there would be pooling at the other extreme—all taxpayer types would find it advantageous to make the election, and the information benefits from the election as screen to determine taxpayers' unobservable types would be lost. Thus, one can view the magnitude of the simplified cash amount, which represents the opportunity cost of forgoing the election, as a key policy lever that the government controls to—at least potentially—induce separation among taxpayer types.

49. For simplicity, I abstract away from the government's compliance costs. There would certainly be costs to the government for promulgating, administering and troubleshooting various aspects of this tax election, but I assume for the purposes of the illustration that they are zero in magnitude.

as compared to other tax elections which require specialized information or have separate deadlines or reporting requirements. Suppose that the taxpayer's execution cost is \$2.

To summarize, the new payoff (tax liability) matrix, after incorporating the compliance costs that accompany the tax election, would look like this:

Taxpayer Type	Elect	Do Not Elect
Honest	$\$34.50 = \$110 * 25\%$ (elective amount * tax rate) + \$5 (deliberation costs) + \$2 (execution costs)	$\$40 = \$10$ (estimation costs) + $\$100 * 25\%$ (actual income * tax rate) + \$5 (deliberation costs)
Dishonest	$\$34.50 = \$110 * 25\%$ (elective amount * tax rate) + \$5 (deliberation costs) + \$2 (execution costs)	$\$30 = \$75 * 33.33\%$ (back taxes and sanctions * audit probability) + \$5 (deliberation costs)

The end result of taking into account the compliance costs of deliberating about and executing the election happens to be the same as the result above. The honest type elects, and the dishonest type does not. The election still achieves complete separation of honest from dishonest types. But adding in the deliberation costs consumes taxpayers' resources in a way that policy-makers must take into account in any normative evaluation of whether to adopt a tax election in the first place, as the next subsection argues.

### *B. A Cost-Benefit Approach to Tax Elections*

The simplified cash amount hypothetical example above shows that in a setting where there are two types of taxpayers that appear as identical to the government, tax elections can generate important informational benefits for the government through screening, so long as the election's parameters are set at levels that induce separation (by type) rather than pooling (across types). This section makes the point that the screening benefits of tax elections cannot be considered in isolation. Screening in the context of tax elections is not costless, and these costs must be weighed against the information and other benefits conferred by screening.<sup>50</sup> Otherwise, there may be a bias in favour of tax elections on account of their screening benefits, even when these benefits may be offset by other costs imposed by a particular tax election. I describe here the other general benefit and cost categories and discuss how

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50. This section focuses on screening-specific costs and benefits with regard to tax elections. It does not intend to give short shrift to the literature on cost-benefit analysis in regulatory

they would be aggregated and assessed. Finally, to show how such a test might be implemented, I apply it to the hypothetical simplified cash amount election.

One clarifying point should be made before walking through the cost-benefit discussion—I assume here that the tax election itself is designed to be revenue neutral. This means that the election is not designed to raise or reduce revenue by attempting to steer taxpayers towards a tax outcome that is different from that which they would have chosen themselves. Obviously, most taxpayers seek to minimize their taxes owed when faced with a tax choice, and this can reduce overall revenue when a tax election is considered in isolation. However, elections are often promulgated to address goals that have nothing to do with revenue, such as facilitating tax classification or easing the administration of the tax code.<sup>51</sup> As such, they can be designed to have a minimal effect on revenues.

#### (i) Screening Benefit

As argued above, this screening element is part of the (possible) benefit of a tax election. To calculate the screening benefit, the government would need to estimate how valuable (in dollars) the information revealed by the screening election is. Such information might be valuable in a number of ways, depending on which policy-relevant characteristics are revealed by the screening election. In the case of the simplified cash amount election, the policy-relevant characteristic is propensity to cheat versus filing honestly, so to continue with the stylized hypothetical, suppose that the aggregate screening benefit is \$500,000 dollars. The benefit can be thought of as costs saved in other aspects of tax administration—better information about taxpayer honesty characteristics is likely to reduce audit and enforcement cost by better targeting taxpayers.

In other cases, as we will see below, the screening benefit may be implementing a marginal tax schedule that minimally distorts productive activity. Where the private information indicates a taxpayer's earning ability or her likelihood of responding to changes in tax rates, the government

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policy or ignore the most basic takeaway of cost-benefit analysis (e.g., that the marginal (social) cost of a given policy be set to equal to its marginal (social) benefit). See David A Weisbach, "Distributionally Weighted Cost-Benefit Analysis: Welfare Economics Meets Organizational Design" (2015) 7:1 J Leg Analysis 151 at 152, n 2, 173–78 (discussing recent literature on the appropriate measures of social cost, benefits and distributionally adjusted weights thereof).

51. See Field, "Choosing Tax", *supra* note 3 at 33–60 (discussing these two specific categories of policy goals that tax elections are frequently designed to serve).

can use this information to adjust anything from the marginal rate schedule for that particular taxpayer to the way it interacts with that taxpayer with regard to the zealotry of its anti-avoidance enforcement efforts.<sup>52</sup>

## (ii) Policy Purpose Benefit

As the literature on tax elections demonstrates, different tax elections are promulgated to achieve a variety of public policy goals or sets of policy goals.<sup>53</sup> For instance, in the case of the election to itemize deductions, the policy goal of allowing itemization is one of “taxation according to ability to pay”.<sup>54</sup> Permitting taxpayers to itemize their deductible expenses by filing the IRC section 63(e) election means that where taxpayers have fewer resources available to pay taxes, for instance as a result of a casualty loss or extraordinary medical expenses, the tax code should recognize this reduction in ability to pay and reduce the tax burden accordingly. This “policy benefit”, in some sense, stands alone, in that it may have been the driving force behind the adoption of the tax election. In the case of the election to itemize, the policy goal of horizontal equity, or “equal treatment across ability to pay”, may be held as sacrosanct and thought to be well served by a particular elective structure.<sup>55</sup> But in other cases, the policy benefit may be less important or achievable at lower cost through some other mechanism. To assess this, empirical estimates are required.

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52. See Alarie, *supra* note 38 at 23.

53. See e.g. Field, “Choosing Tax”, *supra* note 3 (detailing a number of policy purpose benefits that may be served by tax elections, including “reconciling discontinuous [tax] regimes, facilitating tax classification, [and] promoting simplicity and administrability” at 33–65). However, Field acknowledges that “some elections (and, as others may argue, the vast majority of elections) may have little, if any normative merit”. Heather M Field, “Tax Elections & Private Bargaining” (2011) 31:1 Va Tax Rev 1 at 6, n 16. In such a situation where Field might say that a particular election lacked “normative merit”, I would take the same tack but would analyze such a tax election in my cost-benefit framework as one where the policy purpose benefit is zero or very small.

54. Richard A Musgrave, *The Theory of Public Finance: A Study in Public Economy* (New York: McGraw-Hill, 1959) (describing “horizontal equity”, a basic principle of tax fairness). See also John R Brooks II, “Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification” (2011) 2:2 Columbia J Tax L 203 (discussing the connection between horizontal equity and itemization).

55. See Kaplow, *Theory*, *supra* note 9 at 396–98 (critiquing horizontal equity as an incoherent concept).

(iii) Compliance Costs for Taxpayers

The compliance costs for taxpayers are, as described above, divided into two buckets: deliberation costs and execution costs. Deliberation costs are the cost of deciding how to respond to the tax election and in my example, I assume that all taxpayers eligible for the election face them. Execution costs, on the other hand, apply only to those taxpayers who decide to elect out of the default treatment, and they incorporate all the costs of making the elective tax treatment legally effective with the taxing authorities.

I should make clear here that any legal advice about the applicable tax law or implications of a particular elective choice, or analysis about how the law applies to a particular taxpayer's facts, falls within the scope of taxpayer deliberation costs. Put simply, deliberation costs represent all the resources—monetary, psychic, informational, use of time and other valuable resources of the taxpayer—that are inputs into the decision of whether to elect out of the default treatment and into the elective treatment.

(iv) Costs for the Government

Tax elections entail costs for the government as well.<sup>56</sup> The government or the taxing authorities must promulgate and enforce rules about making the election and then must process forms that effect the election and communicate with taxpayers once the election has been recognized. Moreover, where the tax election works as a screening device, the government must analyze the information that is produced by the screen. This (hopefully) is more than offset by the screening benefit described above, but the costs of processing taxpayers' choices and finding correlations with other policy-relevant characteristics must be recognized as an embedded element of the government's administrative costs of tax elections.

(v) Putting It All Together: A Cost-Benefit Rubric

The above four categories of benefits and costs—screening benefits, policy purpose benefits, compliance costs to taxpayers and administrative costs to the government—represent the basic elements of a broad-brush, cost-benefit analysis for tax elections. To be useful, the values of these categories must be estimated empirically. This is necessary to ascertain whether having an election

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56. See Field, "Choosing Tax", *supra* note 3 at 29–30.

is likely to be on-balance welfare-improving or on-balance welfare-decreasing. If benefits of a given (marginal) election exceed its costs, the election is likely to be justified. But if costs exceed benefits, policy-makers should repeal the existing election or seek to restructure it.

To illustrate with reference to the hypothetical simplified cash amount election described above, the analysis might proceed as follows.

First, the government would need to estimate the value of the policy benefit of the election, as well as the value of the screening benefit. In the case of the simplified cash amount example, these benefits are co-extensive. Recall that the policy purpose of the election is to separate taxpayers by honesty type to help the government improve the efficiency and effectiveness of its enforcement activities. Suppose that the information yielded by the simplified cash amount election helped the government target taxpayers such that its audit and enforcement divisions were estimated to save about \$1 million annually.

These combined screening and policy purpose benefits would then be evaluated alongside the two cost parameters of the election. To estimate the compliance costs to taxpayers, one would first take the deliberation costs of \$5 and multiply them by the total number of taxpayers who are eligible for the election and are likely to know about it. Suppose there are 100,000 taxpayers in this situation.

Therefore, the election imposes a total of \$500,000 in execution costs. To calculate execution costs, it is first necessary to estimate how many taxpayers will decide that electing out of the default treatment is advantageous. Suppose that forty percent of the taxpayer population eligible for the election (40,000 taxpayers) will elect out. Each of these taxpayers will incur \$2 in execution costs, for a total of \$80,000.

One more element is necessary: taking into account government administrative costs. The government itself will have to estimate its costs based on its predicted and actual filing and administrative costs relating to the election. For this hypothetical, suppose that government costs are \$300,000.

Thus, the total compliance costs of the hypothetical election are \$880,000 ( $\$500,000 + \$80,000 + \$300,000$ ), as compared to the total benefits (policy purpose plus screening) of \$1 million. The election is justified, but not by a huge margin. Indeed, if the estimates were off, the calculus could change. But, to the extent that the estimates of the (hypothetical) costs and magnitudes of the election are accurate, the cost-benefit calculus helps policy-makers see that the

net benefit of the election is \$120,000. On balance, the hypothetical simplified cash amount election appears to be justified from a welfare perspective.

### III. Itemizing as Screening

This Part applies the theory developed above to a real-world tax election that arises annually for individual taxpayers in the US tax context. I show that the election to itemize under section 63(e) of the *IRC* can be analyzed in a very similar manner to the hypothetical election of the simplified cash amount.<sup>57</sup> First, I provide some institutional background on how the election works and its various policy justifications. Second, I apply the screening and cost-benefit rubric.

#### *A. The Election to Itemize*

The election to itemize has existed since the birth of the income tax in 1913.<sup>58</sup> Its policy purpose is ‘taxation in proportion to ability to pay’—the idea that similarly-situated taxpayers should face similar tax burdens.<sup>59</sup> This idea, also called the principle of horizontal equity,<sup>60</sup> reflects the notion that the tax base should be the income of the individual net of certain expenses that reduce ability to pay because they are, in some sense, senior in priority (i.e., taxes owed to other levels of government) or associated with an involuntary

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57. As I hope the cost-benefit analysis rubric makes clear, significant complexity costs are not transformed from “bads” into “goods” simply because they are necessary for screening. See Lawrence Zelenak, *Learning to Love Form 1040: Two Cheers for The Return-Based Mass Income Tax* (Chicago: University of Chicago Press, 2013) (discussing the citizenship costs of increasing complexity).

58. See Brooks, *supra* note 54 at 207, n 12. The *Revenue Act of 1913* defined “net income” by specifying that it was “subject only to such exemptions and deductions as are hereinafter allowed” *Revenue Act of 1913*, c 16, 38 Stat 114 at 170.

59. See Stiglitz, *supra* at note 12. According to a tax policy memo written by an analyst in the Treasury Department in 1944, “[t]he effect of such deductions is to make more nearly equal the taxes of people of like family status who have the same amount actually available for consumption and for building up their estates”. See also US, Treasury Department, *Simplified Handling of Deductions Under the Individual Income Tax*, Treasury Staff Memorandum (13 January 1944), online: <[www.taxhistory.org/Civilization/Documents/Simplification/HST8670/hst8670-1.html](http://www.taxhistory.org/Civilization/Documents/Simplification/HST8670/hst8670-1.html)>.

60. See Brian Galle, “Tax Fairness” (2008) 65:4 Wash & Lee L Rev 1323.



expenditure.<sup>61</sup> Thus, the horizontal equity rationale explains deductions for items such as state and local taxes, interest on some indebtedness and certain other deductions introduced in the statute in subsequent years, such as extraordinary medical expenses.<sup>62</sup> But by the early 1940s, wartime rising marginal tax rates (which increase the value to taxpayers of claiming itemized deductions) ratcheted political pressure to insulate the tax base from the rising rates.<sup>63</sup> Itemized deductions began to be used to subsidize certain activities that were considered socially desirable.<sup>64</sup> For instance, the list of itemizable

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61. Deducting certain expenses from income stems from the principle that not all expenditures should be considered “consumption” under the Haig-Simons definition of personal income, which is the sum of “the market value of rights exercised in consumption” and “the change in the value of the store of property rights between the beginning and end of the period in question”. Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938) at 50. See also Brooks, *supra* note 54 at 223; Allan J Samansky, “Nonstandard Thoughts about the Standard Deduction” [1991] 3 Utah L Rev 531 (“[s]uch [deductible] expenses may also reflect reductions in ability to pay and are generally involuntary payments that restore the taxpayer to the condition that existed before the event necessitating the payment” at 541).

62. See *Revenue Act of 1942*, c 619, 56 Stat 798 at 819; *IRC*, *supra* note 2 (allowing an itemized “deduction [for] the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent . . . to the extent that such expenses exceed 10 percent of adjusted gross income” at § 213(a)).

63. The United States’ wartime revenue needs brought the income tax to a substantial majority of individual or family units via an increasingly progressive rate structure. Between 1939 and 1944, the highest marginal tax rate rose from seventy-nine percent to ninety-four percent, and the lowest marginal rate rose from four percent to twenty-three percent. See Carolyn C Jones, “Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II” (1988) 37:3 Buff L Rev 685. Jones states that “[f]or government officials, the income tax came to be seen as both a war financing device and as a means of decreasing excess purchasing power. The result was that the income tax rolls increased from about 7 million taxpayers in 1940 to more than 42 million in 1945.” *Ibid* at 686. See also Lawrence H Seltzer, *The Personal Exemptions in the Income Tax* (New York: Columbia University Press, 1968) at 62, Table 9 (showing that the percentage of households paying income tax grew from five percent before World War II to seventy-four percent after); John Brozovsky & AJ Cataldo II, “A Historical Analysis of the ‘Marriage Tax Penalty’” (1994) 21:1 Accounting Historians J 168 (discussing these trends in the context of marriage bonuses and penalties).

64. The deduction for home mortgage interest is indeed a tax expenditure, but its story is a little more complicated. Interest on indebtedness was an itemized deduction since 1913, and only at the time of the *Tax Reform Act of 1986*—when there was momentum to broaden the tax base to allow rates to drop—was the lion’s share of this itemized deduction eliminated. Deductions for personal interest other than mortgage interest on a residence were no longer allowed, but interest on home

deductible expenses was expanded to include charitable contributions.<sup>65</sup> This was seen as being problematic from a horizontal equity standpoint—charitable contributions are, almost by definition, a voluntary taxpayer expense. This change in permissible itemizable expenses undermined the initial policy purpose of itemization by introducing the notion of itemized deductions as tax expenditures rather than a mechanism to impart horizontal equity.

In 1944, the standard deduction was adopted. Its most straightforward purpose was simplification, motivated by the concern that less-sophisticated, lower-income taxpayers would be unable to “navigate the complexities of the tax system”.<sup>66</sup> Taxpayers who elected to use the standard deduction were precluded from claiming itemized deductions.<sup>67</sup> As a result, the standard deduction began functioning much in the same way as the personal exemption in “defin[ing] the

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mortgage interest remained deductible. See *IRC supra* note 2 at §§ 163(a), 163(h)(1), 163(h)(2)(D) (allowing as a deduction all interest paid or accrued within the taxable year on indebtedness; for individual taxpayers, specifically disallowing any deduction for personal interest; but making an exception that for individuals qualified, residence interest is not considered a personal interest). See generally Dennis J Ventry Jr, “The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest” (2010) 73:1 *Law & Contemp Probs* 233. However, allowing discretionary expenditures such as mortgage interest payments to be deductible threatens the principle of horizontal equity as it is traditionally understood. As such, itemizable discretionary expenses such as mortgage interest fall into the category of “tax expenditures”. See Mark G Kelman, “Personal Deductions Revisited: Why They Fit Poorly in an ‘Ideal’ Income Tax and Why They Fit Worse in a Far From Ideal World” (1979) 31:5 *Stan L Rev* 831. This view is echoed, and applied to tax elections more generally, by Rosenbloom, *supra* note 5 at 26. See also Brooks, *supra* note 54 at 229.

65. See US, IRS, *Charitable Contributions* (Pub No 526, Cat No 15050A) (15 January 2016), online: <<https://www.irs.gov/pub/irs-pdf/p526.pdf>>

66. Louis Kaplow, “The Standard Deduction and Floors in the Income Tax” (1994) 50:1 *Tax L Rev* 1 [Kaplow, “Floors”] (“[t]he standard deduction is thought to be an important feature of the income tax because it is a central part of the apparatus that defines the level at which taxation begins and because it saves compliance and administrative costs for the majority of taxpayers who do not itemize” at 1). See also Brooks, *supra* note 54 at 210; Samansky, *supra* note 61. Samansky stated, “[t]he legislative history of the 1944 tax act describes the mechanics of the newly enacted standard deduction, but does not discuss either Congress’ motivation in enacting it or its effect on distribution of the tax burden. Probably its only purpose was simplification.” *Ibid* at 533 [footnote omitted].

67. The 1944 legislation offered taxpayers the opportunity to elect to reduce their taxable incomes by the amount of the “optional standard deduction”, which was defined as ten percent of Adjusted Gross Income (AGI), up to a maximum of \$500 for an individual. See *Individual Income Tax Act of 1944*, Pub L No 315, s 9(a), 58 Stat 231 at 236–37. In its later incarnations, the standard deduction trended toward being a fixed amount rather than a capped percentage of AGI. See Samansky *supra* note 61, at 532–38; Brozovsky & Cataldo, *supra* note 63 at 169,

level at which taxation begins”.<sup>68</sup> However, this development was also at odds with the former purpose of itemization as imparting horizontal equity to the tax system. A large swath of taxpayers qualified for the same flat deduction amount (the amount of the standard deduction) even though they had varying levels of deductible expenses. Today, the “basic standard deduction”<sup>69</sup> is applied by default unless the taxpayer elects under *IRC* section 63(e) to forgo the standard deduction by itemizing her expenses.<sup>70</sup>

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Exhibit II. Following Samansky, the evolution of the standard deduction can be broken down into six phases: 1944 to 1964 (the variable standard deduction based on a percentage of AGI and capped at a fixed amount, as described above), 1964 to 1976 (the “minimum standard deduction” or “low income allowance” that was not based on AGI), 1977 to 1985 (a fixed standard deduction that was called a “zero bracket amount”), 1986 to 1991 (returning to the “standard deduction”, indexed for inflation, and adding an additional standard deduction for taxpayers who were over sixty-five years old or blind), 1991 to 2001 (the same with an except added phase-out, itemized deductions for those with AGIs over \$100,000 are reduced by three percent of the excess) and 2001 to the present (return to fixed standard deduction and eliminated the phase-out of some itemized deductions taxpayers with high AGIs).  
68. Kaplow, “Floors”, *supra* note 66 at 1. See also Brooks, *supra* note 54 at 205–06, 218–28 (arguing that this progressivity rationale for the standard deduction conflicts with the simplification rationale).

69. See US, IRS, *Internal Revenue Bulletins*, Bulletin No 2009-45 (9 November 2009), online: <<https://apps.irs.gov/app/picklist/list/internalRevenueBulletins.html>> at 622 (specifying the inflation-adjusted amount of the standard deduction under *IRC* § 63(c)(2) applies to taxable years beginning in 2010).

70. Although even in the first year of its existence, eighty-two percent of taxpayers elected to use the standard deduction, the “direction” of the default treatment was not reversed until 1986 (i.e., requiring an election to use the standard deduction rather than having it automatically apply by default as it does today under *IRC* § 62(b)). See Samansky, *supra* note 61 at 532. For the purposes of this article, I simplify my analysis by leaving aside the situations in which the standard deduction is not available to a taxpayer even if his or her itemizable deductions are under the applicable threshold. See *IRC*, *supra* note 2 at § 63(c)(6) (those precluded are: married individuals filing a separate return where either spouse itemizes deductions, non-resident alien individuals, individuals making a return under *IRC* § 443(a)(1) for a period of less than twelve months on account of a change in their annual accounting period, and estates or trusts, common trust funds or partnerships). I also do not discuss the more limited standard deduction available to those claimed as dependents on another’s tax return. See *ibid* § 63(c)(5) (for limitation on basic standard deduction in the case of certain dependents).

According to a recent estimate, approximately sixty-four percent of individual returns filed claimed the standard deduction instead of itemizing.<sup>71</sup> Unsurprisingly, the propensity to itemize increases with income, as deductible expenses grow and the return to itemize increasingly outweighs the costs of doing so.<sup>72</sup> There are two reasons that this may be the case. First, expenses during the tax year are generally constrained by current income. Second, many of the expenses that are deductible under current law tend to increase as income rises.<sup>73</sup> Conversely, at lower levels of income, expenses typically are lower (unless debt or some other source of funds is used to finance spending on deductible expenses), thus less frequently justifying the choice to itemize.

### B. *Itemizing as Screening*

Like the hypothetical simplified cash amount election, the election to itemize requires taxpayer heterogeneity. In this real-world example, the dimension across which taxpayers are different is their costs of tax compliance. This is slightly different than the case of the simplified cash amount election, where taxpayers were also heterogeneous as to their costs of accurately estimating and reporting their cash incomes. The notion that taxpayers are likely to have different internal, unobservable costs of itemizing their deductible expenses is intuitive. For those taxpayers on the margin between itemizing and not itemizing, a cumbersome deliberative process may ensue.<sup>74</sup> They must take all the steps necessary to itemize—understanding what itemization is, identifying

71. Calculated using 2008 data from US, Internal Revenue Service, *SOI Tax Stats-Individual Income Tax Returns Publication 1304 (Complete Report)*, Table A, online: <[https://www.irs.gov/uac/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report#\\_tbla](https://www.irs.gov/uac/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report#_tbla)>.

72. See Brooks, *supra* note 54 at 212.

73. The most straightforward example of deductions moving with income is a taxpayer who “tithes” a flat percentage of her income to charity. If she itemizes, she will have a deductible expense that increases with her income. Another example is the home mortgage interest deduction. As incomes rise, it will be possible (and probable) for a taxpayer to finance the purchase of a more expensive home. See US, President’s Advisory Panel on Tax Reform, *Simply Fair and Pro-Growth: Proposals to Fix America’s Tax System* (November 2005), online: <<https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Fix-Tax-System-2005.pdf>>, cited in Brooks, *supra* note 54 at 240 (noting that fifty-four percent of homeowners who pay mortgage interest receive a tax benefit from the deduction). Yet another example is the deduction for state and local taxes paid, which are often based on income.

74. That is, they do not know from past pattern or practice that they are better off itemizing versus taking the standard deduction. For these taxpayers, there are still costs of itemizing, but the deliberation cost component of their compliance costs is much lower, so the screening analysis

itemizable expenses, tracking down information about actual expenses incurred in such categories, determining the sufficiency of any records that need to be kept or attached to the return<sup>75</sup>—and then must compare their total itemizable deductions with the applicable standard deduction. At this point, one would expect the (rational) taxpayer to itemize her expenses only if such expenses exceeded the standard deduction amount.

However, there is evidence that this is not always true. The literature hypothesizes that this is because taxpayers face unobservable costs of itemizing. On top of the deliberation costs discussed above, the execution costs of itemizing—organizing one’s paperwork, tracking down any necessary receipts, actually filling out the required schedule (Schedule A) and exposing oneself to a possible audit in which claimed expenses would need to be substantiated—can be significant.<sup>76</sup> Taxpayers may find it rational to leave money on the table and simply stick with the default standard deduction.<sup>77</sup> Particularly, in regard to one component of the current suite of expenses that can be itemized and deducted on an individual’s Schedule A—charitable contributions—the substantiation (obtaining receipts from the donee organization) and record-keeping (saving receipts for three years) requirements can be onerous.<sup>78</sup>

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is less likely to be relevant. Importantly, this observation—that higher income taxpayers who predictably itemize are unlikely to be within the “separating region” of Figure 1—is consistent with available empirical results. See Mark M Pitt & Joel Slemrod, “The Compliance Cost of Itemizing Deductions: Evidence from Individual Tax Returns” (1989) 79:5 *Am Econ Rev* 1224.

75. The main deductible expense that has these kinds of cumbersome reporting and substantiation requirements is the charitable deduction. On audit, taxpayers must substantiate their claimed deductions, and they are required to have receipts for contributions. For taxpayers with large numbers of small charitable deductions that may have been given in cash, this presents a situation where costs involved in estimating and substantiating total charitable contributions can be quite high.

76. See Zelenak, *supra* note 57. Zelenak highlights the civic costs of the increase in “computational complexity” and “the [complexity] burdens of the profusion of tax expenditures” *Ibid* at 115. With respect to the latter, Zelenak rightly points out that “[t]axpayers cannot easily delegate the year-round burden of keeping the records necessary to claim special tax benefits”, including but not limited to those on Schedule A. *Ibid*.

77. See Pitt & Slemrod, *supra* note 74 (describing the costs of electing to itemize as “[the] actual and imputed compliance costs such as the value of time required to collate receipts and fill out forms and the cost of purchased accounting services. . . [and] the psychic costs (or benefits) related to the compliance activity” at 1225).

78. The substantiation and record-keeping requirements for charitable contribution deductions have become more onerous over the past decade. According to the IRS, “[a] donor cannot claim a tax deduction for any contribution of cash, a check or other monetary gift unless the donor

To make the calculus facing taxpayers more concrete, imagine a churchgoer who tithes a rough amount from her earnings each week when she attends services. She does not keep precise records because she donates using cash. Such taxpayers incur costs of estimating and substantiating their amounts of charitable contributions, much like they would in estimating and substantiating their amounts of cash income. But for others, such as those who always make donations using a credit card and who are highly organized about keeping receipts, the costs of estimating and substantiating charitable gifts may be much lower. Accordingly, for taxpayers seeking to accurately itemize their charitable gifts, there is a story of cost heterogeneity across taxpayers.

Applying the screening model, we know that the higher a taxpayer's internal unobservable costs of itemizing, the more likely she will be to forgo making the election to itemize. Therefore, if taxpayers exhibit a range of internal unobservable costs of itemizing, the existence of the choice between the standard deduction and the election to itemize has the potential to separate the higher-cost itemizers (who will stick with the default) from the lower-cost itemizers (who will opt out and go to the trouble to itemize their expenses).

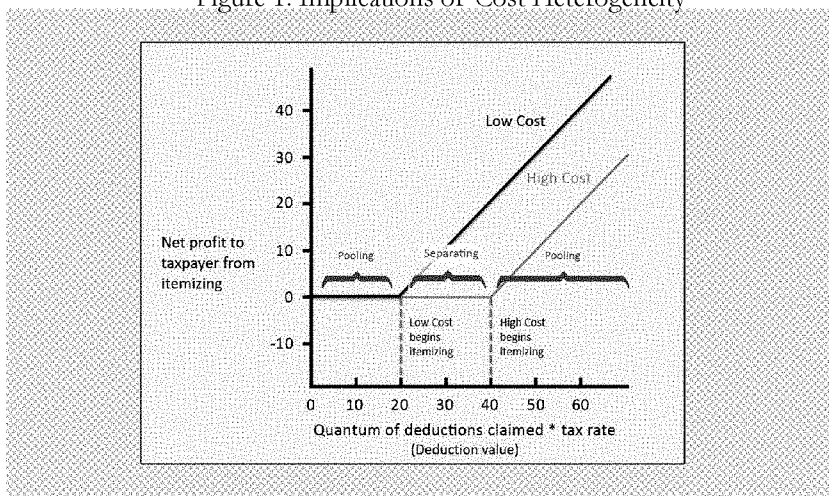
To show how this works in a setting similar to that explored in Part II, imagine that there are two cost types of taxpayers—high and low. Suppose that taxpayers know their unobservable costs of electing to itemize, but the government does not. Suppose also that taxpayers know their net returns from itemizing versus taking the standard deduction after taking into account their unobservable costs of itemizing. They itemize if and only if the net return to itemizing exceeds the net return from taking the standard deduction. Further suppose (just for now) that the standard deduction is zero dollars, and the

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maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or a written communication from the charity (such as a receipt or letter) showing the name of the charity, the date of the contribution and the amount of the contribution.” US, IRS, *Charitable Contributions: Substantiation and Disclosure Requirements*, (Pub No 1771, Cat No 20054Q) (2016) at 3, online: <<https://www.irs.gov/pub/irs-pdf/p1771.pdf>>. In addition, “[d]onors are responsible for obtaining a written acknowledgment from a charity for any single contribution of \$250 or more before the donors can claim a charitable contribution on their federal income tax returns.” *Ibid* at 4. See also US, IRS, *Substantiating Charitable Contributions* (20 May 2016), online: <<https://www.irs.gov/Charities-&-Non-Profits/Substantiating-Charitable-Contributions>>. The surrounding complexity of itemizable expenses is likely to contribute to the extensive confusion among taxpayers about key elements of Schedule A deductions. Recent empirical work has shown that taxpayers have incorrect beliefs about their eligibility to claim tax benefits for charitable contributions as well as for home mortgage interest. See Jacob Goldin & Yair Listokin, “Tax Expenditure Salience” (2013) 16:1 *American L & Economics Rev* 144.

taxpayer of the first type—the type with the lower cost of electing to itemize (Low Cost) has a cost of \$20. The other type has a cost of \$40 (High Cost). High Cost will not itemize until the value of her itemizable deductions (that is, the quantum of deductible expenses she can claim multiplied by her marginal tax rate) exceeds \$40, but Low Cost will begin itemizing once her deduction value exceeds \$20, as illustrated in Figure 1.

Figure 1: Implications of Cost Heterogeneity



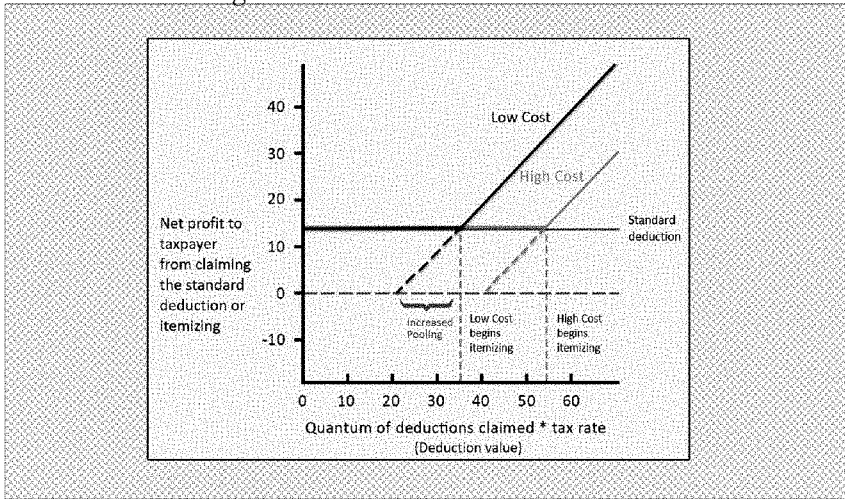
The middle region—which is where only Low Cost finds it optimal to itemize—illustrates where the election to itemize works as a screen to separate between Low Cost and High Cost. In the region to the left, neither type itemizes, so there is no separation (pooling). In the region to the right, pooling occurs again because both Low Cost and High Cost will itemize.

How might we interpret the separating region, in which the election to itemize separates High Cost from Low Cost taxpayers? By definition, the area will be bounded by the deduction values corresponding to the costs of itemizing for the two types of taxpayers. But, more critically, it is likely to correspond to the deduction value range typical of lower-income taxpayers. Extrapolating from Mark Pitt and Joel Slemrod's 1989 study of the costs of itemizing to values in current dollars, taxpayers' unobservable costs of itemizing can be predicted by their incomes but only for those taxpayers who earn more than about \$60,000 in today's dollars.<sup>79</sup> For taxpayers with incomes less than that

79. See Pitt & Slemrod, *supra* note 74 at 1228–229.

amount, their unobservable costs of itemizing cannot be predicted by their incomes. Therefore, the election to itemize “works” here to the extent that it allows the government to discern new information about taxpayers that would not have been available notwithstanding the election.

Figure 2: Effect of the Standard Deduction



To show how the standard deduction can be used as a lever by the government to calibrate where separation will occur on the cost and deduction-value axes, relax the assumption that the standard deduction is zero and instead assume it is \$15. Graphically, we can see in Figure 2 that the separating region shifts to the right. The thresholds at which both Low Cost and High Cost itemizers begin to itemize increases by \$15.

Thus, screening suggests a silver lining to counter the complexity costs of itemizing—if taxpayers, particularly those at the lower end of the income spectrum, have divergent cost profiles, these differences can reduce the propensity for pooling. There may be scope for using the standard deduction to specially target a particular group of taxpayers for separation by shifting the separating region to the right or to the left.

The stylized example demonstrates how separation could work, but how might the government use the election to itemize as a screen in the real



world?<sup>80</sup> Here, the methodology used by Pitt and Slemrod takes center stage. They use observable information about taxpayers who do itemize to estimate the magnitude and determinants of the unobservable costs associated with itemizing expenses for all taxpayers. They can do this even for taxpayers who do not itemize by using data from similarly-situated itemizers via a censored regression model.<sup>81</sup> For each taxpayer, their methodology generates a predicted unobservable cost of itemizing to which they can compare the “revealed” cost that is yielded by the actual choice of the taxpayer. In particular, they analyze Treasury Tax File individual tax return data from 1982 for taxpayers with incomes between \$5,000 and \$100,000 in 1982 dollars. Crucially, for taxpayers with incomes below about \$60,000 in current nominal terms, Pitt and Slemrod find that cost of itemizing cannot be inferred from a taxpayer’s other observable characteristics as reported on her tax return, such as gross income.<sup>82</sup> Thus, Pitt and Slemrod’s methodology provides one example of a framework for deploying the screening account in day-to-day tax administration. Moreover, their empirical results are consistent with a screening story: the election to itemize helps the government learn something about taxpayers that it could not have learned without the election.

### *C. The Policy-Relevant Characteristics Revealed by the Election to Itemize*

So far, we have seen that the election to itemize may act as a screen to reveal information about taxpayers’ unobservable costs of itemizing. For a screening election to be useful to the government, however, these particular costs of itemizing must connect to something larger. What is the relevance for tax policy of being a High Cost versus a Low Cost itemizer? I briefly examine

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80. Sarah Lawsky has argued that asking this question (“how well do the model’s assumptions fit the real world?”) is essential for any tax law article that employs an economic model for its explanatory value. See Sarah B Lawsky, “How Tax Models Work” (2012) 53:5 Boston College L Rev 1657 (for more on the importance of asking this question when providing a model to aid in analyzing the tax law).

81. See Pitt & Slemrod, *supra* note 74 at 1224.

82. After this critical lower-income range, and up to their study’s income limit of \$100,000 (about \$232,000 today), costs of itemizing increase in a linear fashion with income, which Pitt and Slemrod speculate is due to taxpayers’ increasing opportunity cost of time as income rises. For lower-income taxpayers, these variables were not as successful in predicting taxpayers’ costs of itemizing as they were in predicting taxpayers’ benefits from itemizing. The study underscores that the government cannot infer the costs of itemization of lower-income taxpayers from otherwise observable taxpayer attributes. *Ibid* at 1228–229, n 8.

three possibilities: taxpayer cost of itemizing as being linked to ability to earn, tax responsiveness and propensity to evade.

(i) Cost of Itemizing as a Tag for Taxpayer Earning Ability

In the psychology literature, the trait of “conscientiousness” is one of the so-called “big five” personality characteristics and is associated with the qualities of being methodical and dependable: “being careful, thorough, responsible and organized . . . [as well as] hardworking, achievement-oriented, and persevering.”<sup>83</sup> Psychologists have noted that the label conscientiousness “does not fully reflect the qualities of planning, persistence, and purposeful striving toward goals that are part of it”,<sup>84</sup> and they have therefore proposed alternative labels for the trait, such as “constraint” and “responsibility”.<sup>85</sup> All of these descriptions point towards lower personal costs of record keeping and organization of information that are necessary to execute the election to itemize and lower costs of analyzing receipts and completing the actual filing activities (whether directly or through a tax preparer) at the end of the year. All else equal, taxpayers who have higher levels of conscientiousness may be more likely to itemize.

Moreover, psychologists have devoted increasing attention to the relationship of personality to vocational behavior and outcomes.<sup>86</sup> There is a “growing consensus” that conscientiousness is linked to vocational ability

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83. Murray R Barrick & Michael K Mount, “The Big Five Personality Dimensions and Job Performance: A Meta-Analysis” (1991) 44:1 *Personnel Psychology* 1 at 4.

84. Charles S Carver & Jennifer Connor-Smith, “Personality and Coping” (2010) 61:1 *Annual Rev Psychology* 679 at 683.

85. *Ibid.*

86. See Nancy E Betz & Fred H Borgen, “Relationships of the Big Five Personality Domains and Facets to Dimensions of the Healthy Personality” (2010) 18:2 *J Career Assessment* 147 (noting that “[l]iterature reviews and meta-analyses have suggested significant relationships of personality to a number of indices of academic and job performance and job satisfaction” at 147). Another study sought to link the healthy personality inventory (seventeen personality traits organized into five broader styles), which predicts career confidence, and the Big Five dimensions of personality. Betz and Borgen have found “impressive” strength in the relationship between “HPI Productivity styles [confident, organized, detail-oriented, goal-directed traits] with Conscientiousness”. *Ibid* at 152–56. This study confirmed the results of meta-analyses. See Gregory M Hurtz & John J Donovan, “Personality and Job Performance: The Big Five Revisited” (2000) 85:6 *J Applied Psychology* 869 (“[o]verall, it appears that global measures of Conscientiousness can be expected to consistently add a small portion of explained variance in job performance across jobs and across criterion dimensions” at 876).

indicators (such as job and training performance ratings) and productivity measures (such as sales volume, salary and goal-setting motivation).<sup>87</sup> There is robust evidence that more conscientious individuals tend to have higher productivity and better job performance.<sup>88</sup> A recent meta-analysis found that “[p]ersons who are hard-working, persistent, and achievement-oriented bring with them behavioral tendencies that are important to workplace success”, and that conscientiousness is a better predictor of performance than most cognitive factors.<sup>89</sup> Another study concludes that “[d]ue to their disposition, conscientious individuals tend to display higher levels of work motivation, achieve higher levels of job performance and career success, and emerge more often as leaders than their less conscientious counterparts.”<sup>90</sup> On the other hand, there are many reasons to think that a taxpayer that reveals an unusually high cost of itemizing might also have other difficulties relating to tax compliance.

This information can be useful to the government. First, to the extent that cost of itemizing functions as a tag for earning ability, the election to itemize could give the government valuable insight into how to design a more efficient tax system. As mentioned above, at the heart of optimal tax theory lies the idea that those with higher ability to earn should face lower marginal tax rates but higher infra-marginal tax rates. Putting issues of political feasibility

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87. Steven D Brown et al, “Social Cognitive Career Theory, Conscientiousness, and Work Performance: A Meta-Analytic Path Analysis” (2011) 79:1 J Vocational Behaviour 81 at 82.

88. Barrick & Mount, *supra* note 83 at 1. Barrick & Mount have investigated “the relation of the ‘Big Five’ personality dimensions (Extraversion, Emotional Stability, Agreeableness, Conscientiousness and Openness to Experience) to three job performance criteria (job proficiency, training proficiency, and personnel data) for five occupational groups (professionals, police, managers, sales, and skilled/semi-skilled)”. *Ibid* at 1. They have shown that conscientiousness “was found to be a consistently valid predictor for all occupational groups studied and for all criterion types”. *Ibid* at 17–18. Barrick and Mount have concluded that “it is difficult to conceive of a job in which the traits associated with the Conscientiousness dimension would not contribute to job success” and note that the Big Five personality dimensions are also relatively independent of measures of cognitive ability. *Ibid* at 21–22.

89. Brown et al, *supra* note 87 at 89. Brown et al have noted that “the results of this study suggest that self-efficacy and goals only partially (rather than fully) mediate the relation between conscientiousness and work performance. Conscientiousness also appears to relate directly to performance over and above the self-efficacy beliefs that conscientious persons tend to develop and the challenging goals that they set for themselves.” *Ibid*.

90. Ute R Hülshesger & Günter W Maier, “The Careless or the Conscientious?: Who Profits Most from Goal Progress?” (2010) 77:2 J Vocational Behavior 246 at 248 [citations omitted]. Hülshesger & Maier find support for “the prediction of the compensation perspective that affective job

(and constitutionality) aside, information from the election to itemize could be used to target the imposition of an alternative kind of tax schedule for certain taxpayers identified as having high earning ability. Such taxpayers could be offered an “upside-down U-shaped” tax schedule. Such a schedule would be highly progressive up to a certain income threshold and then rates would fall, potentially to zero. Such a system would violate principles of vertical equity with respect to the shape of the tax schedule but might improve the government’s ability to redistribute income from high-ability earners to low-ability earners. The intuition is that, past the earning threshold at which progressivity ends and rates begin decreasing, such a schedule would not be related to the high earning-ability taxpayer’s labour effort. She would be free to deploy her substantial earning abilities with zero distortion to her marginal labour effort. Depending on such taxpayers’ elasticities of taxable income (i.e., the extent to which a small increase in tax on their next dollar of earned income reduces their willingness to earn that next dollar), a well-calibrated upside-down U-shaped rate schedule could raise more revenue at lower efficiency cost.

Second, tags of earning ability can function to channel resources, including filing assistance, to needy taxpayers in the dynamic setting of annual filing, in the following sense. The annual filing period of most income tax systems provides the government with information about taxpayers each and every year. Suppose that a taxpayer for whom the election to itemize had yielded the tag of “high earning ability” in the past suddenly filed a return in which she took the standard deduction. Absent other information showing that her income sources and amounts had changed dramatically, this could provide a clue that the capacity of that taxpayer to navigate tax filing complexities had diminished. Imagine the case of a retired taxpayer who lives on a fixed income

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attitudes of employees high in conscientiousness are unaffected by goal progress, while the attitudes of employees low in conscientiousness tend to be dependent on goal progress”. *Ibid* at 252. Conscientiousness is also associated with other unobservable characteristics that may predict taxpayer ability. For instance, research has demonstrated that high conscientiousness individuals have greater academic achievement. See Sabrina Trapmann et al, “Meta-Analysis of the Relationship Between the Big Five and Academic Success at University” (2007) 215:2 J Psychology 132. But see LA Witt et al, “The Interactive Effects of Conscientiousness and Agreeableness on Job Performance” (2002) 87:1 J Applied Psychology 164 at 168 (noting that conscientiousness combined with agreeableness was the best predictor of job performance). Moreover, there is evidence that conscientiousness relates to “more engagement coping” in response to stressors, in contrast to “disengagement coping”, where withdrawing from a stressor precludes problem solving. See Carver & Connor-Smith, *supra* note 84 at 697.

and generally itemizes, but then submits a return in which she does not itemize. Such a taxpayer may benefit from being connected with filing assistance for the following year, even if she does not qualify for a low-income taxpayer filing assistance program by virtue of her fixed income. Moreover, the taxpayer may be in need of other social services in her community, and the election to itemize could play a small but potentially important role in helping identify this need.

(ii) Cost of Itemizing as Linked to Responsiveness to Taxation

Taxpayers who have lower unobservable costs of itemizing will find it worthwhile to elect to itemize while taxpayers who have higher unobservable costs of itemizing may choose at that same point to take the standard deduction. Therefore, the unobservable cost reveals information about the willingness of taxpayers to take steps to reduce their tax liability. The taxpayer who finds it worthwhile to go to the extra effort of filing Schedule A may also be a taxpayer who finds it worthwhile to structure her affairs in a certain way to reduce her tax burden. She may be more interested in tax-reducing actions,<sup>91</sup> she may positively like learning about taxes and how to avoid them or she may be eager to deprive the government of a few dollars of extra revenue. Whatever her underlying motivation, the taxpayer who has lower unobservable costs of electing out of the default treatment (in this case the standard deduction, but in another case perhaps a default structure for a business compliance) will be more likely to avail herself of the alternative: the elective treatment which reduces her effective tax burden. This results in precisely the type of “tax tailoring” that Benjamin Alarie describes in regard to government’s partial efforts to police tax avoidance compliances.<sup>92</sup>

Note that a taxpayer who is relatively tax inelastic, or unresponsive, with respect to the decision to itemize is arguably less likely than a taxpayer who is highly responsive to strategically alter her labour effort, consumption,

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91. This could include, at the extreme margin, expatriating. While the dramatic increase in the number of US expatriations has been attributed largely to the Report of Foreign Bank and Financial Accounts (FBAR) and *Foreign Account Tax Compliance Act* (FATCA) regimes, repatriating to reduce one’s income tax liability is certainly a conceivable objective of a tax-responsive individual. See Robert W Wood, “U.S. Citizens Renouncing Skyrocket—The Tina Turner Effect”, *Forbes* (15 November 2013), online: <[www.forbes.com](http://www.forbes.com)> (in 2013, the trend was up thirty-three percent from previous high in 2011).

92. Alarie, *supra* note 38 at 22–26.

investment or national domicile decisions based on the burden of taxation. In turn, the government needs to worry less about deterring this taxpayer's productive activities than in the case of the first taxpayer, who may be more likely to alter her labour effort, spending or other decisions in response to tax incentives.

(iii) Cost of Itemizing as Linked to Taxpayer Compliance Posture

Let us return for a moment to Alex Raskolnikov's proposal for adopting a dual tax enforcement regime to better match taxpayers' motivations for compliance with the type of enforcement approach used by the government. In lieu of a full-scale adoption of his proposal, pursuant to which taxpayers choose one of two enforcement regimes, the screening information yielded by the election to itemize might be usefully pressed into service to advance the more general idea, as discussed in other work by Raskolnikov, of targeted enforcement.<sup>93</sup>

I argue here that information conveyed through the election to itemize can be used to improve the examination and audit process. In particular, someone who is a high-cost itemizer (that is, by comparison to what the censored regression model predicts as her cost of itemizing) means she is unlikely to find it worthwhile to add every last itemizable expense to Schedule A or to bother filling out the form when the standard deduction is available. All else equal, she will have a higher tax bill than the low-cost itemizer. This willingness to forego tax savings in favour of keeping things simple may assist the government in classifying her as a compliance-oriented taxpayer. On the other hand, it might find that a taxpayer who has unusually low costs of itemizing should be audited more aggressively, particularly if an initial correspondence showed her to be comfortable pushing the limits of the tax law. Using available information, such as that which can be gleaned from a tax election, like the election to itemize, is consistent with the IRS' strategic goals and use of cost-benefit information in allocating enforcement resources.<sup>94</sup> In particular, it could remedy some of the problems that have been recently identified with its correspondence audit

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93. See Alex Raskolnikov, "Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty" (2006) 106:3 Colum L Rev 569.

94. See US, Treasury Inspector General for Tax Administration, *The Use of Return on Investment Information in Managing Tax Enforcement Resources Could Be Improved*, Ref No 2013-10-104 (Washington, DC: Department of the Treasury, 2013), online: <<https://www.treasury.gov/tigta/auditreports/2013reports/201310104fr.pdf>> (stating that the IRS does consider information

program and also assist it in better allocating general enforcement resources in general.<sup>95</sup>

This approach of using taxpayer-specific information to drive the audit selection contrasts with what is known about current techniques used by the IRS to select taxpayers for audit and examination. In particular, the DIF score that is assigned to a tax return reflects the likelihood that an audit will yield an increase in tax revenues.<sup>96</sup> There is no taxpayer-specific data used except what is reported on tax forms, and many taxpayers are frustrated at having to expend resources in responding to a correspondence or other type of audit that was triggered, without explanation, by the discriminant function. To the extent that information about taxpayers' unobservable costs of itemizing is correlated with propensity to evade or file aggressive tax positions, the DIF technique could be augmented to target cheaters and bypass compliance-oriented taxpayers.

#### (iv) Cost-Benefit Analysis of the Election to Itemize

The previous subsection set out a number of ways in which the information revealed by the election to itemize might be useful to the government. This usefulness, however, must be placed in the context of the overall costs and other benefits of the election to itemize. Here, I briefly go through the four elements of the cost-benefit test to describe how such an analysis would play out.

Recall that the cost-benefit analysis requires adding screening benefits to the policy purpose benefits of allowing itemization and then comparing them to the total compliance costs (for taxpayers and the government) of itemizing.

The three possible screening benefits of the election to itemize—revealing taxpayer earning ability, indicating taxpayer responsiveness to taxes and

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about costs and benefits in allocating its enforcement budget, but criticizing the extent to which such information is actually used in selecting enforcement projects).

95. See US, Government Accountability Office, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden*, GAO-14-479 (June 2014), online: <[www.gao.gov/assets/670/663840.pdf](http://www.gao.gov/assets/670/663840.pdf)>. “Tax professional groups, congressional stakeholders, and the National Taxpayer Advocate have all raised concerns about taxpayers’ burden and experience in the correspondence audit program. According to IRS officials, the comments critical of the program prompted IRS to start a comprehensive program review in 2012.” *Ibid* at 11 [footnote omitted].

96. See discussion of the DIF technique in J Manhire, “Toward a Perspective-Dependent Theory of Audit Probability for Tax Compliance Models” (2014) 33:4 Va Tax Rev 629 at 642. See also David Cay Johnston, “Your Taxes: Some New Tricks To Help Filers Avoid An Old Audit Trap”, *The New York Times* (25 February 1996), online: <[www.nytimes.com](http://www.nytimes.com)>.

helping backstop enforcement efforts—must be empirically estimated by the government. Depending on which benefit is strongest, the government may reap outsized gains from using the information. Say, for instance, that low revealed cost of itemizing tracks very closely—as an empirical matter—to responsiveness to tax. The government might find that mitigating some of its adversarial tactics in auditing the taxpayers who are likely to be most responsive to tax changes would drastically reduce the number of taxpayers who slip into outright evasion or, more dramatically, who flee the jurisdiction for tax purposes. This effect—the bottom-line upside of using information produced by a screening election to improve a dimension of the income tax—must also be empirically estimated to get the first element of the cost-benefit analysis. Suppose for now that the screening benefit was estimated to be \$1 billion.

The second element of the cost-benefit analysis—the policy purpose benefit of the election—is, by its nature, more difficult to match with a precise dollar value. Because legislators or tax administrators are likely to balk at the exercise of valuing long-standing notions of horizontal equity that are embedded in the election to itemize, we can assign this policy purpose benefit a placeholder value of \$X. Assuming we have numbers for the other three values—screening benefit, taxpayer compliance costs and government compliance costs—we can solve for the threshold at which the election becomes welfare increasing.

The third element is taxpayers' aggregate compliance costs of complying with the election (i.e., their internal unobservable costs of electing to itemize).<sup>97</sup> These were estimated by Pitt and Slemrod to be \$1.44 billion in 1982 or—recalibrated for inflation and a rise in the absolute number of tax returns of itemizers—\$4.53 billion in today's dollars.<sup>98</sup> Youseff Benzarti estimates the burden of filing Schedule A to be much higher: over \$600 per taxpayer or

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97. It is worth noting that internal compliance costs do not account for non-individually recognized costs of tax complexity, such as erosion of citizenship norms. See Zelenak, *supra* note 57.

98. See Pitt and Slemrod, *supra* note 74 (for estimates of the aggregate itemization costs incurred by taxpayers using 1982 taxpayer data—i.e., pre-*Tax Reform Act of 1986*, when there were many changes to the itemized deduction categories). Pitt and Slemrod's aggregate cost estimate of \$1.44 billion was denominated in 1989 dollars, which (adjusted for inflation) is about \$3.52 billion in 2013 dollars. This is almost certainly an underestimate, because the number of taxpayers who itemize has grown substantially since 1982. In particular, using Pitt and Slemrod's average cost of itemizing of \$43 and multiplying it by the number of taxpayers who itemized in 2010, the most recent year available, yields an economy-wide taxpayer cost to itemizers of \$4.53 billion dollars. *Ibid* at 1229, Table 2. See also US, IRS, *Individual Income Tax Returns, 2010*, by Justin Bryan,



approximately 0.2% of gross domestic product.<sup>99</sup> These numbers give some sense of the magnitude of the taxpayer compliance costs that can be created by a tax election.

The last empirical estimate needed for the cost-benefit analysis—the government’s compliance costs of promulgating and administering the election to itemize—is also hard to come by. The government has provided limited disclosure about its costs in managing the election to itemize. For now, suppose a reasonably good estimate can be made by assuming that government compliance costs are some fraction of taxpayers’ aggregate costs of complying—to take one arbitrary fraction, suppose the government’s costs of receiving, processing and policing the election to itemize are one tenth of taxpayers’ costs. This implies that the election to itemize imposes compliance costs on the government of \$453 million.

Putting these estimates together, we can solve for the variable representing the policy purpose benefit (i.e., the amount that would justify the election from a welfare standpoint). Assuming that the screening benefit is \$1 billion and the total compliance costs of the election are about \$4.98 billion (\$4.53 billion plus \$453 million, using Slemrod and Pitt’s results in this illustration), the policy purpose benefit necessary to make the election “break even” from a net welfare perspective is about \$3.98 billion. Perhaps an argument can be made that the virtues of horizontal equity are of this magnitude. But given that the horizontal

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SOI Bulletin 5 (Fall 2012) at 59, online: <<https://www.irs.gov/PUP/taxstats/productsandpubs/12infallbulincome.pdf>>. Bryan calculated this amount by multiplying 46,644,509 returns by the 2010 value of \$43, which is \$97.13, for a total of \$4.53 billion. However, \$4.53 billion is likely to be a conservative estimate of the total transaction costs imposed by the election to itemize for three reasons. First, it is unlikely to include the costs of deliberating about the election for those taxpayers who end up choosing to stick with the default standard deduction (i.e., the deliberation costs of non-itemizers). Second, it probably does not include the deliberation costs of itemizers—these taxpayers will be making their decisions to itemize on the margin, once the costs of deliberating have been sunk, so will itemize if and only if the payoff from itemizing is greater than the payoff from the standard deduction, after taking into account their costs of filing the election (i.e., it assumes that they have already deliberated about the outcomes of each alternative). Third, this estimate does not include the costs to the government of administering the election to itemize.

99. Youssef Benzarti, “How Taxing Is Tax Filing?: Leaving Money on the Table Because Of Hassle Costs” (2015) at 32–33, online: SSRN <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2412703](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2412703)>.

equity purpose of the election has already been diluted,<sup>100</sup> it is likely that the election to itemize should be eliminated or radically reformed to drastically reduce the number of taxpayers who have to grapple with its complexities. In turn, this would reduce costs for the government. While raising the standard deduction or otherwise phasing out the election to itemize might compromise the quality of information the government has about taxpayers' policy-relevant characteristics, this dampening of the screening benefit might be well worth the costs that would be saved in the process.

## Conclusion

Screening devices offer one way to resolve problems created by information asymmetries. This article's primary contribution is to highlight the importance of screens with respect to a prominent feature of numerous income tax systems—elective tax provisions.

In their most straightforward formulation, screens feature an information-constrained principal, such as the government in the tax context, that forces agents such as taxpayers to choose between two options. Where the agents vary in their sensitivity to the costs set out in the options, agents' rational elective choices can allow the principal to draw inferences about the agents' cost sensitivities.

This article argues that tax elections can work as screens. To illustrate how a tax election can yield information for the government about a range of tax-relevant sensitivities of taxpayers, this article walks through a hypothetical election called the simplified cash amount election. The hypothetical election works mechanically to separate honest-type taxpayers from dishonest-type taxpayers in regard to reporting untraceable cash income. Extending this analysis to a real-world tax election, I argue that the *IRC* section 63(e) election to itemize deductions is likely to work as a screen to generate valuable information for the government about taxpayers' varying earning abilities, their responsiveness to taxation and their voluntary compliance postures.

While revealing private taxpayer information may be an important function of status quo tax elections, this article also shows that a welfarist-oriented

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100. See Brooks, *supra* note 54 at 209 (arguing that horizontal equity has been diluted by the presence of the standard deduction as well as the inclusion of tax expenditures such as charitable contributions and the home mortgage interest deduction in the list of otherwise involuntary expenditures that have been deductible since the beginning of the income tax).

policy-maker should prefer tax elections in circumstances where the policy purpose benefits of offering an election, plus the benefits from screening, is greater than the costs to taxpayers and the government of complying with and administering the tax election. In this sense, tax elections with screening benefits are not necessarily socially desirable. Even with screening, a (marginal) tax election's benefits may not exceed its costs. With respect to the election to itemize and other status quo elections, tax agency estimates of the costs as well as the benefits (including screening benefits) can enable policy-makers to ruthlessly eliminate those tax elections that do not provide net benefits.

Thus, this article's screening thesis challenges the consensus view of tax elections as necessary evils by offering a silver lining. Even while the most questionable tax elections remain on the books, investigating and accounting for their potential screening benefits represents low-hanging informational fruit that should be harvested rather than squandered by the government.

