

# Studies in Budget & Tax Policy



June 2011

## Prefilled Personal Income Tax Returns

A Comparative Analysis of Australia,  
Belgium, California, Québec, and Spain

edited by François Vaillancourt





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# Contents

Foreword Prefilled personal income tax returns: An examination of five cases / v  
*by François Vaillancourt*

Chapter 1 Australia / 1  
*by Chris Evans and Binh Tran-Nam*

Chapter 2 Belgium / 23  
*by Magali Verdonck*

Chapter 3 California / 39  
*by Brian Erard*

Chapter 4 Québec / 63  
*by François Vaillancourt*

Chapter 5 Spain / 73  
*by José M. Durán-Cabré*

About this publication / 91



Foreword

# Prefilled personal income tax returns

## An examination of five cases

by François Vaillancourt<sup>1</sup>

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<sup>1</sup> We thank our authors for useful comments on this introduction

The genesis of this set of five papers on prefilled (or pre-populated) personal income tax returns was the observation that the Québec government had initiated in December 2007 a prefilled personal income tax program. A target group of 100,000 tax filers, 80% of whom were age 65 or older were to receive a prefilled form for the 2007 tax year. The stated intent was that, for the 2008 fiscal year, 300,000 individuals filing a paper form should receive a prefilled form; for the 2009 fiscal year, this should be offered electronically to 1,000,000 tax filers; and for the 2010 fiscal year almost all Québec tax filers would receive a prefilled form. This program of using prefilled tax returns was ambitious both in its intended coverage and in the speed with which it was to be rolled out. It was also only the second subnational program we are aware of. It thus seemed appropriate to carry out a study of that program's implementation in 2008, something that could be done only when the relevant data became available in late 2008. Chapter 4, by François Vaillancourt, examines the Québec program. It also seemed appropriate to compare Québec's experience with prefilled tax forms to that of other tax jurisdictions implementing such a program. The most obvious candidate for inclusion in this comparison is California's ReadyReturn program since it is the other program at the subnational level. Chapter 3, by Brian Erard, discusses this. One was then left with choosing other countries. After examining a list found in a publication of the Organisation for Economic Co-operation and Development (Forum on Tax Administration Taxpayer Services Subgroup, 2006) and drawing on our knowledge of tax collection arrangements, we selected three<sup>2</sup> countries—Australia, Belgium and Spain—that like Canada are federal in the nature of their intergovernmental financial and tax arrangements, if not in their constitutions, and for which information on the prefilled program could be found. Thus, we also have Chapter 1, by Chris Evans and Binh Tran-Nam, on Australia, Chapter 2, by Magali Verdonck, on Belgium, and Chapter 5, José M. Durán-Cabré, on Spain. We now briefly summarize these chapters following their order in the book before drawing together the relevant comparative points.

## Chapter 1 Australia

The Australian paper starts with a history of the development of prefilled forms in that country. They have roots that can be traced back ten years or so—the “A New Tax System” initiative (ANTS) (Costello, 1998)—and are linked to a public-policy debate on tax simplification. It then describes how prefilling was implemented progressively from 2004/2005 onwards and

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2 So overall, studies for five countries were carried out; this allowed us to meet both time and budget constraints.



formally introduced in 2006/2007. This was done by making more and more information available from one year to the next in electronic form to both tax agents (tax portal) and to self-preparers (e-tax). Users of paper forms did not gain access to this information. Use of prefilled forms in Australia thus creates an incentive to use electronic filing. One must note that prefiling in Australia does not result in the Australian Tax Office (ATO) sending out a prefilled return; rather, it makes it possible for individuals (self-preparers) and tax agents to use downloadable information when preparing income tax returns that will be filled out electronically.

There are currently 12.6 million individual tax filers in Australia; 72% use tax agents and 28% are self preparers. The majority of self-preparers use e-tax. Tables 1.1 and 1.2 show both an increasing and high use of prefilled information. For 2008/2009, the use by individual e-filers is 90% (table 1.1) while for tax agents it can be inferred to be above 75%. In 2006/2007, these rates were respectively 60% and about 20%. That said, we do not know how much information is used since these percentages indicate that a tax filer or a tax agent retrieved a file; they may have used only one, several, or all items of information available. The growth in use is most likely the result of both greater familiarity with e-tax and the availability of more prefilled information.

The Australian paper presents a wide-ranging discussion of prefiling in Australia that has applications beyond it. The following points are worth noting:

- the lack of systematic evaluations of the costs and savings for tax administrations of introducing prefilled returns—such programs are often asserted to reduce costs but there is little empirical evidence to support or dispute such a claim;
- the impact on the nature of self-assessment since, as more and more prefilled data becomes available to tax filers, their role as a self-assessor becomes less well defined;
- the impact on tax-auditing activities since the availability of prefilled data to taxpayers and their acceptance of the data diminishes the need of tax authorities to audit individual taxpayers;
- the impact on tax culture as prefilled data may be perceived by individual taxpayers as the ATO's "goodwill" in revealing what it knows about them;
- the fact that taxpayers with complicated personal tax affairs may find that the tax administration knows little about them while other taxpayers may be surprised it knows so much about their financial affairs.

## Chapter 2 Belgium

Belgium first offered prefilled returns in 1995 to a subset of taxpayers, pensioners.<sup>3</sup> This pilot was a failure, particularly as it attempted to calculate the income tax owed before receiving corrected returns from tax filers. In 2005, following the introduction of e-filing in 2003, prefilled returns were again offered; self-preparers, tax accountants, and civil servants helping tax filers prepare their return can use them. Users of the system obtain free access to tax preparation software. The amount of data available in prefilled form has increased since 2005 but there are still differences in the provision of electronic information by similar financial institutions.

The introduction of e-filing and of prefiling as an incentive to e-file is part of an e-government initiative, the so-called Copernicus reform. The concomitant introduction and the data available make it difficult to distinguish the impact of the two programs. But, only 30% of Belgian tax filers use e-filing; this is low. To understand why, the Belgian government surveyed Belgians in 2008. Users of e-filing, which include users of prefilled reports but is not limited to them, indicated high satisfaction with the system: 94% of them would recommend using it to acquaintances. Non-users were asked what could be done to entice them to use e-filing; data protection and information on how to use the system (user guide, assistance) were mentioned. Two interesting points were raised: being given a tax rebate for e-filing and being sure that e-filing did not have an impact on the amount to be paid or the delay in finding out this amount. The first point may be the result of neighbouring French taxpayers being offered a rebate for e-filing at that time.

## Chapter 3 California

Chapter 3 begins by describing the first ReadyReturn project, as prefiling is known in California. This pilot of this program started in 2005 (2004 taxes) for an invited sample of 51,850 Californians filing state income tax returns and who had very simple returns—single, no dependents, claimed the standard deduction, had only wages income from only one employer. The pilot program was repeated in 2006 and take-up during these years was approximately 22%.

A more complete version of the program was implemented in 2008 (2007 taxes). While it was claimed that there were one million eligible tax filers, 367,000 ReadyReturns were “readied” and 11,253 were ultimately filed. The program was continued for 2009 with 1.9 million eligible tax filers. The 2008 version had limitations on eligibility similar to those for 2005/2006 but

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3 Using a paper form; that was the dominant mode of tax filing then.

participation was not by invitation but by having eligible tax filers opt in. In 2009, eligibility was broadened by allowing tax filers with dependents but an income cap was put in place.

The chapter reports the results of a survey both of those who accepted and those who rejected an invitation to participate in the 2005 pilot. Participants indicated high satisfaction with the program—“easy to understand,” “more convenient than standard return,” “will use again” all got scores above 90%. Non-participants gave various reasons for not doing so: “using an accountant/tax preparer” was the most common (29%). One notes that 11% did not like receiving such a return from the government and 10% had to file a federal return first.

One unique aspect of this chapter is the examination of the impact of the program on tax filer behaviour over time. Its greatest impact has been a permanent increase in the e-filing rate of participants in the pilot. Finally, the chapter finds that the savings in compliance costs for tax filers using prefilled returns are very likely to be higher than the net administrative costs of the program.

## Chapter 4 Québec

Chapter 4 begins by reviewing the reasons for introducing prefilled tax forms. This initiative was presented to the public in part as a way to ease the life of older residents; it is not part of a grand scheme towards e-governance. The chapter then describes its use in its first year, 2008. A sample of tax filers for the fiscal year 2007 who were aged 65 or older and individuals with a low income who had used a paper form to file in the three previous tax years, who had simple tax profiles—simple transfer-type incomes, no children, no transfer between spouses of income and so on—were invited to use a prefilled form. These tax filers were informed in January of their selection and asked in February if they wanted to participate. Those who did, received in March the prefilled return, which was due on April 30, the tax-filing deadline for both federal and provincial individual tax filers in Canada. They then had to make sure they were truly eligible to participate (no change in marital status, types of income, and so on). They could not change the prefilled amounts.

Of the 100,000 tax filers in the sample, 93% received a prefilled form and 30.9% filed a prefilled return. Users of the prefilled return were younger than non-users. Comparing the predicted status of returns—receives a refund, settles up an amount owed, or amount paid is amount due—with their observed status, one finds that 81% had matched outcomes while receipt of refunds was higher than expected. The vast majority of users (94%) of the prefilled form did not need to add any information.

Why did some who were invited not use the prefilled form? We have information on this from two sources: phone calls to Revenu Québec declining to participate and answers to a questionnaire sent with the prefilled form. Two main reasons emerge from the phone answers: the form was received too late (in mid-March)<sup>4</sup> and the respondent preferred the standard form. Those who answered the written questionnaire also stated familiarity with the standard form but added that the prefilled form did not allow users to establish the amount owed, positive or negative (refund). Users who answered the written questionnaire were almost unanimous (above 90% for four questions) in praising the prefilled form. The program is now offered solely to users from the previous year. It was not expanded as planned.

## Chapter 5 Spain

Chapter 5 first describes the Spanish personal income-tax system. An interesting feature is that, since 1990, the Spanish tax administration has made available to the public at low cost tax calculation software (PADRE). It is now used by more than 90% of the population. From 1998 (1997 tax year) to 2002, the tax administration made available to tax filers data on various kinds of income; tax filers had to seek this out in person, by phone, or over the Internet since it was not sent to them. From 2003 (2002 tax year) onwards, the tax administration made available a prefilled tax return, first to a large pilot group of 1,500,000 tax filers with tax withheld at source in 2003 and, since 2004, to all tax filers. With the expansion of the program to all tax filers an option was introduced allowing participants to request either tax information or a prefilled return: if the administration decides that due to missing data it cannot prepare a prefilled return, it simply sends the information that is available to the taxpayer. By 2009, almost all Spanish tax payers were obtaining either tax information or a prefilled return from the tax administration and 72% of tax returns filed were prefilled; 55% of those are approved without alteration by the taxpayer. A survey conducted in 2008 shows that 94% of tax filers prefer a prefilled return over tax data and that most tax filers are quite satisfied with prefilled returns. One interesting finding is how the introduction of the prefilled option allowed the tax administration to terminate a parallel system it had put in place to deal with individuals who were owed a refund due to over-withholding.

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4 Most income statements are in the hands of tax filers by the end of February so filing by the first week of March is usually feasible.

## Conclusion

This note has focused on prefilled tax forms in the jurisdictions of five tax administrations. The conclusions drawn from these five cases should be read in the context of the larger and expanding body of work on prefilled forms. In general, one finds a major difference in approach between the three national, and the two subnational, authorities. The objective of the Australian, Belgian, and Spanish initiatives from their outset appears to have been to maximize the amount of information available to taxpayers when preparing their tax returns. None of these revenue bodies seemed to have had the goal of producing a fully completed tax return. In the case of Spain, however, their system has evolved to the point where a fairly large number of taxpayers now receive what is regarded as a fully completed return. On the other hand, Californian and Québécois authorities endeavoured from the outset of their projects with prefilled forms to produce a fully completed return for a selected subset of their taxpayers. Given the information available and existing tax complexity, it turns out that these population subsets were relatively quite small.

### To be noted

First, prefilled tax forms are not usually introduced all at once but usually rolled out gradually over time, with a pilot phase. One variant is to first offer tax information, then a prefilled return. Here we report on the use of a more or less successful pilot in four cases and note that the addition with the passage of time of more eligible tax filers and more information is observed across all multi-year cases.

Second, survey evidence from Belgium, California, Québec, and Spain shows very high satisfaction by users of prefilled returns. This seems to be a service that, once tried, is extremely hard to refuse.

Third, the survey evidence shows that resistance to change is due in part to inertia—familiarity with the old tax form—and in part to uncertainty about the new system—will it be flexible enough? will it do the tax calculations correctly? One also notes the resistance of some Californians to an extended role of government in the tax field, something very different from the situation in Belgium and Spain, where tax preparation software is produced by the government and provided free of charge or at low cost to tax filers.

Fourth, the use of prefilled returns to encourage e-filing probably works. Requiring those who want to use a prefilled return to file electronically probably imposes a higher compliance burden on older, less computer-savvy, tax filers but this will become less important as the internet becomes an integral part of daily life. Is it proper to create such a linkage is a valid question.

Fifth, the end result is that, in some of the jurisdictions (California, Québec, and Belgium), the use of prefilled tax returns remains more or less

a niche program with a relatively small percentage of filers eligible and willing to use the service; while, in other jurisdictions (Spain, Australia), the program is more pervasive. It is not clear why this is so but first, differences in the complexity of taxes, withholding systems, and the timeliness of availability of withholding information from employers may play a role; and second, differences among taxpayers in their perception of how well their privacy will be protected under such programs and in their Orwellian concerns about “Big Brother” may also play a role.

Sixth, timeliness both in sending out prefilled returns, which depends on the timeliness of the receipt and processing of information on income obtained from various bodies (employers, financial institutions, government agencies), and in processing returned prefilled returns matters if a substantial number of tax fillers expect a tax refund.

Seventh, prefilled returns do not represent a panacea for the compliance burden imposed by a complex personal income tax system. The taxpayers with the most complex circumstances bear the largest share of the overall burden of tax compliance and prefilled returns often are not an option for them. Nonetheless, such programs do seem like a sensible way to reduce the compliance burden for taxpayers with relatively simple tax circumstances at either low cost or, even, savings for the tax administration.

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Chapter 1

# Australia

by Chris Evans and Binh Tran-Nam<sup>1</sup>

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<sup>1</sup> The views expressed in this chapter are those of the authors and do not necessarily reflect the views of Atax, University of New South Wales, or the Fraser Institute. Information provided by Nick Botfield, Director of Pre-filing of Tax Returns, Australian Taxation Office (ATO), is gratefully acknowledged, as are the comments of an anonymous referee of this chapter.



# 1 Introduction

Like the rest of the developed world, Australasian tax reforms in the past 30 years have exhibited many efficiency-enhancing features: lower income tax rates, tax base broadening, a change in tax mix towards indirect taxation, and increased neutrality and uniformity in tax structures. In New Zealand and Australia, these outcomes have reflected the pro-market policies initiated in the 1980s by the then Treasurers Roger Douglas and Paul Keating, respectively. Increased legal complexity and increased tax operating costs (defined as the sum of tax administrative and compliance costs) were undoubtedly outcomes that derived from such policies in Australia and New Zealand, as well as in Canada and most certainly the United States (see Sandford, 1993). This is ironic as tax simplicity has long been recognized as a criterion for good tax policy and tax simplification was declared to be a key rationale for many of the tax reforms taking place in the 1980s and 1990s. The increase in tax operating costs (whether in absolute or relative terms) and the loss of tax simplicity have also clashed with the stated economic strategy of microeconomic reforms in many member countries of the Organisation for Economic Co-operation and Development (OECD).

Prefilled (or pre-populated or pre-completed) income tax returns represent one of the latest tax simplification initiatives being undertaken in many OECD countries (Highfield, 2006; OECD, 2008). Their use began in Denmark in the late 1980s and subsequently has spread to other Nordic and EU countries (ANAO, 2008). They have also been adopted, or are in the process of being adopted, at sub-national levels in North America (for example, in California and Québec). In Australia, the prefilled tax returns program (formally known in Australia as “pre-filling service - e-tax” or simply “pre-filling,” a terminology adopted in this chapter;<sup>2</sup> is relatively new, having been first mooted in 1998 and formally introduced in 2006/07 after minor trials in earlier years.

More recently, pre-filling has received high-level official endorsement, initially from the *Henry Review of Australia's Future Tax System* (Australian Treasury, 2009), and subsequently in the Government's response to that review (Australian Government, 2010) and in the May 2010 Budget. Recommendation 123 of the *Henry Review* argues that “pre-filled personal tax returns should be provided to most personal taxpayers as a default method of settling their tax affairs each year” (2009: 104). In turn, the Government has apparently accepted this “tick and flick” approach, though—as discussed later in the chapter—it may not have entirely understood the ramifications when it did so.

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2 While “pre-filling” appears as “pre-filling service - e-tax” on a web page of the Australian Taxation Office (ATO) (<http://www.ato.gov.au/individuals/content.asp?doc=/content/58871.htm>), it is known within the ATO as “pre-filling of income tax returns” or more often as just “pre-filling.” The term “e-tax” is omitted because e-tax is used by self preparers (individuals) while three quarters of pre-filling use is by tax agents via the Tax Agent Portal.



The principal aim of this chapter is to examine in detail the experience of pre-filing in Australia. The organization of the remainder of the chapter is as follows. Section 2 provides a more detailed background discussion of pre-filing in Australia, including the drivers of change and its historical development. Section 3 presents a description of the current state of play of pre-filing in Australia and discusses some of the issues that have arisen during its implementation. Finally, section 4 presents a preliminary assessment of the impact of pre-filing and considers a number of proposals that could enhance its performance.

## 2 The development of pre-filing in Australia

### 2.1 The drivers of change

As in the case of many other OECD member countries, the introduction of pre-filing in Australia can be seen as a direct result of two separate developments: [1] the desire for income tax simplification; and [2] improvements in information and communication technology.

Personal income tax (PIT) in Australia is imposed by the federal government and collected by the Australian Taxation Office (ATO) in accordance with the Income Tax Assessment Act 1936 (Cth), Income Tax Assessment Act 1997 (Cth) and other legislation, including the Tax Administration Act 1953 (Cth). It is by far the largest single source of tax revenue in Australia.<sup>3</sup> The simplification of PIT has been a major and ongoing issue in Australia. This is because the Australian PIT has long been perceived as being complex by all conventional measures such as legal complexity, tax compliance costs, and proportion of personal taxpayers using professional tax advisers.

In terms of sheer size, Australian income tax legislation is massive.<sup>4</sup> The length of the Income Tax Assessment Act 1936 (Cth) has increased from 126 pages at its inception to over 5,000 pages prior to the introduction of the Income Tax Assessment Act 1997 (Cth). The combined length of the two Acts now stands at about 7,000 pages, after the recent removal of a significant number of pages (close to 30%) of inoperative provisions in the 1936 and 1997 Acts. Reading the Australian income tax legislation is difficult and

3 In 2007/08, PIT raised net revenue of AU\$128 billion, accounting for over 61% of income tax revenue, almost 45% of all federal tax revenue, and almost 37% of all tax revenue (ABS, 2008).

4 In Australia, the Tax Law Improvement Project (TLIP) was launched in 1994 with the simplification objective of rewriting the 1936 income tax law to provide a better structure and make it easier to understand. As a result, an updated but incomplete income tax act was passed in 1997. Due to the discontinuation of the TLIP in 1998, income tax in Australia is now governed by two parallel pieces of legislation: the Income Tax Assessment Act (ITAA) 1936 (Cth) and the Income Tax Assessment Act (ITAA) 1997 (Cth).

requires university education. Attempts at legal simplification by rewriting tax legislation in simpler English and a more coherent manner have yielded very limited successes.<sup>5</sup>

In a (now dated) comprehensive study of the compliance costs arising from federal taxes, Evans et al. (1997a: 20) found that in 1994/95 personal taxpayers (excluding sole traders) spent, on average, 8.5 hours per annum on tax affairs and almost AU\$100 on tax adviser costs (CPI indexed to AU\$137 in 2006/07 prices; ABS, 2009: tables 1, 2). In aggregate terms, the compliance costs accounted for 4% of the net income tax revenue collected from personal taxpayers.<sup>6</sup> Although there is no updated study of the compliance costs arising from personal income tax in Australia, it is reasonably safe to conclude that the overall level of tax compliance costs has not shown any sign of declining. Indeed, the average costs to an individual for managing tax affairs (essentially fees paid to advisers and excluding the value of the taxpayer's own time or any incidental costs) was AU\$268 in 2006/07, an increase of nearly 7% on the 2005/06 figure (ATO, 2009a: 140).<sup>7</sup>

In an earlier publication based on the same study, Evans et al. (1997b: 52) found that the most common reason (62.3%) for people to seek professional advice was to comply with the legal requirements imposed by their tax obligations. In this regard, the proportion of individual taxpayers<sup>8</sup> relying on the services of tax agents for the completion and lodging of their tax returns has increased tremendously, from approximately 38% to 40% in 1977/78 (McKinstry and Baldry, 1997) to well over 70% in the period since 1996/97 (Davidson, 2009: 6–7). Australian individual taxpayers are generally considered to be among the most agent-dependent in the developed world (McKinstry and Baldry, 1997: 126). An OECD survey established that 77% of all PIT returns in Australia were prepared with the assistance of tax professionals in 2004 (OECD, 2005: table 9). Only Italy (with 96%) had a higher figure than Australia. However, the proportion of individual taxpayers using tax agents has slightly decreased in recent years, falling from a peak of 77.53% in 1999/2000 to 72.46% in 2006/07 (ATO, 2009a: 9).<sup>9</sup>

5 According to Smith and Richardson (1999: 330), the Flesch readability index has improved from 38.44 for the ITTA 1936 to 46.42 for the ITTA 1997. Both scores fall well short of an index of 65 for plain English speaking.

6 This does not include the tax compliance costs of the PAYE system, trusts, and so on. When sole traders were included, individual compliance costs accounted for 5.6% of the relevant tax revenue (Evans et al., 1997b: 65).

7 Note that the estimate by Evans et al. of tax adviser costs refers to personal (individual non-business) taxpayers only, while the ATO estimate is related to all individual taxpayers.

8 Including both personal (individual non-business) and individual business taxpayers.

9 Arguably, and intuitively, this reduction in dependency upon tax agents may be connected with the growth of e-filing generally and pre-filing in particular, although there is as yet no empirical evidence to prove that this is the case.

It is thus not surprising that Australian federal governments have taken an active role in attempting to simplify the PIT system in the past 20 years. Various reports have been commissioned and various initiatives undertaken: for example, the Beddall Report (Parliament House of Representatives, 1990), the 1990 Tax Simplification Task Force, the Joint Committee of Public Accounts (JCPA) Report (1993),<sup>10</sup> the “A New Tax System” initiative (ANTS) (Costello, 1998), the Review of Business Taxation (the Ralph Review) (1999), the Banks Report (Regulation Taskforce, 2006) and, most recently, the Henry Review (Australian Treasury, 2008). In addition, strong calls for tax reform have been received in the past ten years from different quarters of the Australian society (for a summary, see Tran-Nam et al., 2006). However, many of these proposals focus mainly on tax simplification from a policy perspective (such as the removal of work-related deductions or “negative gearing”<sup>11</sup>) rather than focusing on the simplification of tax administration.

In Australia, annual filing of income tax returns under the principle of self-assessment has been mandatory for most individual taxpayers for many years. As noted by the OECD (2008: 5), this is similar to the case in about 15 of the 30 OECD members, where the system of personal income tax effectively requires universal filing. Some have contended that Australia should adopt appropriate administrative reforms that would place it in the other half of OECD countries where universal filing is not required. For example, Evans (2004) has argued the case for reduced annual filing for certain personal income taxpayers in Australia. He identified three conditions for making such a reduction possible: [1] fewer personal tax rates (Australia has had up to five or six); [2] a more comprehensive and cumulative regime for withholding taxes at source; and [3] the removal of most work-related deductions. To date, however, Australia has not moved in this direction, preferring instead to adopt the less radical alternative of pre-filing returns, recognized by some as the next “big thing” in the administrative reform of the Australia’s PIT system (Highfield, 2006).

The need to simplify personal income tax highlighted above has been accompanied by significant improvements in information and communication technology and the ability of revenue authorities to harness these developments. These improvements have resulted in a substantial reduction in the costs of storing, transmitting, retrieving, and manipulating massive amounts of tax-related data. Further, the widespread availability of PCs and the Internet, as well as the improvements in database languages and integrated software, has made it feasible for the ATO to offer improved electronic services in

10 The Atax study undertaken by Evans et al. (1997a, 1997b) was commissioned as a direct result of the JCPA’s recommendations.

11 “Negative gearing” refers to the income tax law that allows individual taxpayers to deduct expenses incurred on investment activities (such as shares and real property) from their taxable income in a non-quarantined manner.

response to taxpayers' needs. In this sense, the use of prefilled tax forms is closely related to the ATO's use of data matching in tax administration.

## 2.2 Historical overview

The concept of pre-filling in the PIT system has been on the political and administrative agenda in Australia for over ten years, and has enjoyed political support from both the previous Liberal (Coalition) federal government (in power from 1996 to 2007) and its Labor successors. In its ANTS document (Costello, 1998: 148–49), the Liberal federal government foreshadowed the introduction of prefilled income tax returns by discussing the replacement of the taxpayer annual tax return by an income statement generated by the ATO for personal taxpayers with relatively simple tax affairs. It was stated that the ATO would introduce a test of these income statements for the financial year 2000/01 (Costello, 1998: 149), although nothing specific appears to have subsequently emerged from this announcement. In its 1998/99 report on tax file management, the ANAO (1999) suggested that the ATO should be able, in principle, to provide the information it had available in its data matching activities to certain types of taxpayers to simplify the completion and lodgement of their annual income tax returns. The ATO accepted this recommendation, although again little appears to have happened in the immediately following years.

In March 2002, the ATO commenced its “Listening to the Community” project aimed at making it easier, cheaper, and more personalized for taxpayers to comply with their tax obligations. The project consisted of focus groups, creative retreats, and surveys with various user groups (tax agents, small business, individuals, large business, and not-for-profit and government organizations). The program was first documented and published in 2003 (ATO, 2003) with annual updates. The second guiding principle of the program, which stated that “taxpayers will have on-line access to information that is personal to their dealings with the ATO,” was closely related to the ultimate introduction of pre-filling.

The ATO introduced the practice of pre-filling returns using e-tax (a free tax return preparation and lodging software for self-preparing personal taxpayers, first developed by the ATO in 1999) in the financial year 2004/05 (ANAO 2008: 84). In this pilot, the pre-filling information was limited to two types of data collected by agents of the Australian Federal government, namely, Centrelink (social security) payment summaries and medical expenses recorded by Medicare Australia. In 2005/06, the pre-filling pilot was expanded to include the 30% childcare rebate, and interest and managed fund information from selected financial institutions.

In the 2007/08 budget speech, the then federal Treasurer Peter Costello (2007) announced that an additional AU\$20 million would be provided to the ATO to enable it to design and implement a more comprehensive pre-filling service for personal income taxpayers in 2007–08 and subsequent financial

years. Costello stated that the intention of the initiative was to simplify the completion of tax returns for about nine million Australian taxpayers who lodge their tax returns either by e-tax (self-preparer) or via their tax agents. Pre-filling was expected to be fully operational in 2008/09.

The amount of information and the functions available from the ATO as part of the pre-filling have steadily increased over the years. For the 2006/07 financial year, pre-filling information was received from third parties progressively throughout July and August 2007. The pre-filling data available to e-tax users in that year was rather limited and included details related to various government payments, the 30% child-care tax rebate details, interest income, dividend income, and certain managed funds distributions.

In the 2007/08 financial year, the information and functions of pre-filling were expanded. The pre-filling options available in e-tax and the Tax Agent Portal became identical. In addition to the data available in 2006/07, e-tax users and tax agents could also access details of:

- Medicare levy related items, including private health insurance details;
- Higher Education Loan Program (HELP) and prior year deductions;
- Pay As You Go (PAYG) payment summaries submitted electronically (only available through e-tax in 2007);
- Baby bonus information (only available through e-tax in 2007); and
- Family Tax Benefit (FTB) status indicator (only available through the Tax Agent Portal in 2007).

E-tax users were also able to import their reports into their agents' software. Similarly, tax agents could make use of the multi-tax file number (TFN) function that allowed them to enter up to five client TFNs and Medicare card details at the same time.

In addition to the range of information available for pre-filling in 2008, the 2009 e-tax pre-filling service provided the following information:

- PAYG payment summaries that have been sent to the ATO on a paper form;
- PAYG income tax instalments;
- relevant items of private health insurance rebate details;
- rental property address details from taxpayers' 2007/08 rental property schedule; and

- reminders of letters that had been sent to taxpayers throughout the year in relation to their work-related expenses and notice if they needed to submit a schedule of work-related expenses this year.

The introduction of pre-filing in Australia has thus followed an incremental path—pre-filing data has been enhanced gradually over time.

### 3 Description of pre-filing in Australia

#### 3.1 How pre-filing currently works

The implementation of the pre-filing program has been coordinated by the Electronic Initiatives of the Micro Enterprises and Individuals Business line of the ATO. It is still in an early stage and the focus to date has been upon consolidating the existing data and addressing issues raised with the ATO by agents and through feedback and at consultative forums (D'Ascenzo, 2009).

Pre-filing in Australia basically leverages the ATO's data matching activities. In fact, pre-filing is defined by the ATO as the provision of information that it typically uses for data matching purposes, directly to an individual e-tax preparation or record-keeping tool. Thus, the option of using prefilled income tax returns is only currently available to individual taxpayers who have lodged at least one tax return through e-tax, and authorized tax agents through the Tax Agent Portal. Pre-filing in Australia is not yet available to those using paper-based income tax returns (who may be self-preparers or who may be using a tax agent with a paper-based workflow).<sup>12</sup>

Pre-filing is intended to make the completion of electronically submitted income tax returns easier, faster, and more personalized. For personal taxpayers, it may also reduce the likelihood of later tax review or audit since the pre-filing information provided to taxpayers is basically the same as the matching data used by ATO in auditing.<sup>13</sup> To take advantage of pre-filing, e-tax users are required to review the pre-filing information, amend it (if necessary), and add any missing data. At this stage, it is strongly recommended that e-tax users review pre-filing information as it may be erroneous or incomplete. Taxpayers remain responsible for the returns they lodge,

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12 According to published statistics, about 11.8 million individuals lodged income tax returns in 2006/07 (ATO 2009a: 10). About 25% or 3.3 million were self-preparers while the vast majority lodged through tax agents. Among self-preparers, approximately 1.4 million did not use e-tax and 1.9 million lodged through e-tax. Among e-tax lodgement, about 61% or 1.16 million made use of pre-filing.

13 This view is supported by Nick Botfield, ATO's Director of Pre-filing of Tax Returns, who also suggested that data on possible correlation between pre-filing and auditing will be collected by the ATO in the future (Botfield, January 2010, personal communication).



even if they have used prefilled information. The use of e-tax (and thus pre-filling data) is not binding as self-preparing taxpayers can lodge their tax return on-line one year and by paper in another year. Also, those using e-tax do not have to use any prefilled information that may be available—its use is entirely optional.

### 3.2 Information currently provided by pre-filling

Pre-filling is only relevant for personal taxpayers when they are in the process of preparing and lodging their compulsory annual tax returns. Individual taxpayers not using tax agents are required to lodge their tax returns of the last financial year (July 1 to June 30) by October 31 of the new financial year. For individuals using tax agents, the due date is extended to May 15 of the following year.

The information that is currently available to taxpayers under the pre-filling service is a mixture of rolled-over information from earlier years' returns and third-party information made progressively available in the period from July to October immediately following the close of the fiscal year (June 30); most of this is available by mid-August. The following information is provided (ATO, 2009b):

- personal details, including name, address, and Australian Business Number (ABN), rolled over from the 2008 tax return so long as that was submitted using e-tax and the same computer is being used to submit the 2009 return;
- PAYG payment summaries received from third-party employers and containing details of salary, wages, allowances, earnings, tips, directors' fees, employers' lump-sum payments, Australian government allowances and payments, total reportable fringe benefits amounts, and various categories of other income;<sup>14</sup>
- government payments provided by agencies such as Centrelink, Department of Veterans Affairs and Department of Education Employment and Workplace Relations (this information includes details of taxable payments including pensions and allowances and tax exempt amounts that may relate to tax offsets);

14 One change introduced in 2009 is that individual non-business payment summaries lodged on paper, not electronically are displayed in this "PAYG payment summaries" section. Approximately 7.8 million payment summaries were lodged by employers by July 28, 2008 and, by August 14, 2008, the figure had increased to 10.8 million, which represented a 37% increase in the number of payment summaries lodged on-line in 2007/08 compared to the preceding year (Bland and Clarke, 2009). The figures for 2008/09 are not yet available.

- interest income from a large number of financial institutions and share registries, including lists of income-bearing accounts (savings and term deposit) in the taxpayer's name or held jointly with a spouse (from 2008 onward);
- dividend income (sole and joint with spouse) from most listed public corporations—so long as the corporation holds the TFN of the taxpayer concerned (which is not mandatory);
- managed fund distributions (sole and joint with spouse) from a large number of managed funds—so long as the fund holds the TFN of the taxpayer concerned (which is not mandatory);<sup>15</sup>
- a very limited set of deductions (relating to work-related uniform or clothing, other work-related expenses and gifts or donations) and only available where the total deductions claimed on the 2008 tax return amounted to less than AU\$300;<sup>16</sup>
- HELP and Student Financial Supplement Scheme (SFSS) data;
- data on the status of Baby Bonus claims for those who have previously claimed this allowance and who have an on-going entitlement to claim;
- Medicare benefit tax-statement details for the taxpayers and their dependents under 18, showing amounts paid for medical expenses and claimed back from Medicare;<sup>17</sup> and
- details of private health insurance policy and rebates, which can obviate the need for the individual to complete these details on the tax return.

In addition, in 2009, new details or reminders were displayed under the “Important information” section (where relevant to taxpayers) about rental

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15 Bland and Clarke (2009) note that the number of “investor records” (presumably a combined total of the three categories of interest income, dividend income and managed fund distributions) increased by 65% in 2007–08 compared to 2006–07, to a total of 49.3 million records lodged on-line by the end of October 2008.

16 Given that 80% of individuals (7.6 million) claimed work-related expenses in 2006/07 at an average of over AU\$1,800 per claimant (ATO, 2009a), it is likely that there would be very few taxpayers who are able to take advantage of this aspect of pre-filling.

17 This information is used to establish whether the taxpayer may be entitled to a 20% tax offset for medical expenses and may calculate it in limited circumstances—though the likelihood of the existence of medical expenses not dealt with through the Medicare system and the exclusion of spouses mean that the data will be complete for only a few individuals.



property addresses from the 2007/08 rental property schedules, pre-lodgement advisory letters, schedules of work-related expenses required with lodgement, income from forestry managed-investment schemes, the entrepreneurs' tax offset, the remaining balance of any land-care and water facility tax offsets, PAYG income tax, the accumulative low rate cap, income averaging for primary producers and special professionals, and net farm management account deposits or withdrawals. Information about the status of Family Tax Benefit (FTB) claims has been removed from the 2009 prefilled form as a result of the 2008/09 Federal Budget decision to transfer the administration of FTB payments to the Family Assistance Office.<sup>18</sup>

### 3.3 Participation in pre-filling

The use of the pre-filling service has been monitored by the ATO. The use of pre-filling, both by e-tax self-preparers and tax agents, has increased substantially in the past two years (tables 1.1 and 1.2). This rapid rise in the popularity of prefilled income tax forms, particularly in 2007/08, is possibly due to:

- the 2007/08 Budget announcement of the pre-filling initiative;
- pre-filling becoming more visible in e-tax; and
- more pre-filling information becoming available, making it a more useful service to a wider group of taxpayers.

But, note that no information is available on the extent to which individuals retrieving prefilled data used the various categories of information. For example, an individual may have used data from only one or two categories in 2006/07 and data from three or four categories in 2007/08; but it is also possible that an individual may have used fewer categories in 2007/08 than in 2006–07. The totals are merely raw totals of individuals who used some aspect of the prefilled data in each of the years and do not show the extent of use.

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<sup>18</sup> The Family Tax Benefit assists families with the cost of raising children. It is payable to children under 21 years or full-time students aged between 21 and 24 subject to various conditions including an income test. Prior to July 1, 2009, the ATO acted as an agent for the Family Assistance Office (FAO) and administered claims for FTB. In a streamlining administrative reform announced in the 2008/09 federal budget, the option of receiving payments and service delivery from the ATO was removed from July 1, 2009 onward. FTB will now be administered by FAO via Centrelink or Medicare Australia. In short, FTB is now viewed by the government as a social welfare (family) issue rather than a tax issue.

**Table 1.1: Participation in pre-filling by self-preparers, 2006/07–2008/09**

	2006/07	2007/08	2008/09 (at Dec. 9, 2009)
Total e-tax lodgement	1,917,171	2,216,706	2,356,410
Number of e-tax lodgers who used pre-filling	1,162,339	1,548,253	2,110,292
Ratio of e-tax lodgers who used pre-filling (%)	60.6	69.8	89.6

Source: Bland and Clarke, 2009; unpublished data provided by Nick Botfield, Director of Pre-filling of Tax Returns, Australian Taxation Office, January 2010, personal communication.

**Table 1.2: Downloads of pre-filling reports via the Tax Agent Portal, 2006/07–2008/09**

2006/07	2007/08	2008/09
<i>July 1, 2007–Dec. 9, 2007:</i> <b>1,604,649</b>	<i>July 1, 2008–Dec. 9, 2008:</i> <b>3,586,841</b>	<i>July 1, 2009–Dec. 9, 2009:</i> <b>4,895,845</b>
<i>July 1, 2007–June 6, 2008:</i> <b>1,930,252</b>	<i>July 1, 2008–June 6, 2009:</i> <b>6,164,159</b>	<i>July 1, 2009–June 6, 2010:</i> <b>7,500,000*</b>

\* Estimated.

Source: Unpublished data provided by Nick Botfield, Director of Pre-filling of Tax Returns, Australian Taxation Office, January 2010, personal communication.

## 4 An evaluation of pre-filling in Australia

### 4.1 General comments

Despite its conception dating back to the late 1990s, the implementation of the pre-filling initiative in Australia is relatively recent and is arguably only partial in comparison to programs in other countries. There is not yet sufficient quantitative data to analyze its impact on tax administration in any rigorous fashion. Nonetheless, it is possible to make a preliminary, qualitative examination of the impact of pre-filling based on [1] how it operates and [2] past empirical studies of tax administrative and compliance costs in Australia. It is helpful to start by making some overall remarks regarding this initiative.

The introduction of pre-filling of income tax returns is perceived as reform of tax administration. The pre-filling initiative is indeed primarily concerned with the administration of the tax system and it appears to be independent of the income tax law. Yet, it is not always easy to separate tax administration from tax policy. This is especially true in Australia, as pre-filling does not appear to have been an ATO-driven reform, at least initially. As discussed in section 3, the early impetus was provided by the Australian Treasury (in the 1998 ANTS document) and by the ANAO (in its 1998/99 report on tax file management), and the ATO largely reacted to those initiatives. Simplifying income tax returns was seen by the Australian Treasury, in the 1998 ANTS document, as a minor reform associated with the far more significant reform based on the Goods and Services Tax. In addition, the budget for developing pre-filling was provided by the Australian Treasury

to the ATO as an additional, separate resource, rather than from the ATO's existing, internal resources. Having said that, it seems fair to remark that, well before additional resources were made available to the ATO for the development of pre-filing, the ATO had taken a proactive role in making pre-filing inevitable through its "Listening to the Community" project discussed previously.

Pre-filing also has interesting, practical implications for two fundamental concepts in the administration of income taxation in Australia, namely self-assessment and tax auditing. The principle of self-assessment still requires taxpayers to keep records and justify their claims, and taxpayers and their agents can choose whether or not to avail themselves of any of the information that is made available. However, as more and more pre-filing data become available to e-tax users, and as they come to trust and use that information more and more, there may be a danger that the role of the personal taxpayer as a self-assessor becomes less well defined.

Similarly, the ATO's need to administer the income tax system via its tax auditing activities may change as pre-filing information expands. This is primarily because, in the past, the ATO possessed the same information as the pre-filing data but did not reveal that information to taxpayers. Rather, the information was employed in data-matching exercises as part of the tax auditing process of individual taxpayers. The availability of pre-filing data to taxpayers and their acceptance of the data may therefore diminish the need of the ATO to audit individual taxpayers. However, at the same time, the ATO can now focus its attention and efforts on those individual taxpayers who do not use pre-filing. This is consistent with the ATO's tax compliance model according to which those taxpayers who want to comply will be assisted to do so by the ATO.

## 4.2 Early problems

A number of teething problems with pre-filing have been identified by the ANAO (2008), the ATO (2009b), and the press (Sampson 2007; 2008): timeliness, comprehensiveness, availability, and reliability and accuracy.

### *Timeliness*

The first major issue is the timeliness of pre-filing information. The current legislation that regulates the provision of third-party information requires the employment and financial data be provided to the ATO no later than August 14 and October 31 following the end of the tax year, respectively (ANAO, 2008: 85). These deadlines are potentially too late for many e-tax users who want to submit their income tax returns early in order to get tax refunds, and have prompted the ANAO to recommend that the ATO "discuss with the Treasury ... bringing the dates forward for the provision of requisite third party data" (ANAO, 2008: 86).

### *Comprehensiveness*

As a direct result of the timeliness issue, the range of pre-filling information is, for practical purposes, currently not as comprehensive as the government would like it to be. The ANAO report notes, in particular, that the TFN is not always attached to third-party information, largely for privacy reasons, and recommends that the ATO should engage in initial discussions with Treasury in order to explore options for legislative change that would permit the inclusion of TFNs “on some additional data sets, having regard to the need to balance privacy concerns and improving the efficiency and effectiveness of public administration” (ANAO, 2008: 85–86).<sup>19</sup>

In addition, because of technical problems, some supposedly available pre-filling information may not actually be made available. For example, the ATO’s website in 2008 stated that the service regarding private health insurance information was turned off at a critical time because of technical problems associated with this information (Sampson, 2008).

### *Availability*

There may also be problems for personal taxpayers in being able to use the pre-filling service, as its availability is limited to the period when e-tax is available. For example, e-tax was only available for about six months following the end of the 2009 tax year, which meant that personal taxpayers who may have wanted to use pre-filling in that year could not always do so. Apparently the short time frame in that particular year was attributable to a major systems conversion that took place in January 2010 and was not typical: in other years it was available for between eight months and 11 months. It is understood that the standard ATO offering in future years is likely to be 11 months, which should obviate much of this problem.

### *Reliability*

A further issue is that pre-filling information may not be reliable. Some instances of inaccurate pre-filling data have been reported in the press (e.g., Sampson, 2007, 2008), although in response the ATO has claimed that the number of situations detected where pre-filling data has been found to be erroneous, measured against the number of downloads made in practice,

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<sup>19</sup> In Australia, there is privacy legislation designed to protect individuals from being identified in public documents or data sets. As a result of this privacy legislation, third-party data providers (such as banks) are not legally required to supply TFNs along with tax-related information although many of them choose to do so. When data are supplied without TFNs, the ATO needs to use its data matching search engine to identify the corresponding TFNs. The ANAO was seeking to make it legally mandatory for third-party data providers to supply TFNs.

has been miniscule. Nonetheless, in a self-assessing environment, a careful checking of pre-filling data is essential for all taxpayers and tax agents who choose to use it.

#### *Other problems*

Further problems with pre-filling have been identified by the ATO (2009b). These include human error in the external information-provider lodgement process and lack of understanding by taxpayers. Issues highlighted by the ATO itself are:

- duplicated records: affected investments show amounts that are double what they should have been;
- interest derived from share investments: prefilled interest from accounts unknown to taxpayers (because [1] interest-bearing securities reported by share registries rather than a bank, and [2] bank accounts overlooked by investors);
- reporting of interest, dividends, and managed fund distributions: occasionally reporting of investment income is undertaken by another organization related to the investment body, causing major confusion (e.g. Colonial First National reports on behalf of the Commonwealth Bank of Australia for some of their managed fund distributions); and
- taxpayers quoting incorrect TFNs to financial institutions.

### **4.3 Evaluation of benefits**

It has been claimed that pre-filling income tax returns generates substantial benefits to taxpayers, tax administrators, and governments (Highfield, 2006: 331; OECD, 2008: 4). Such claims are, however, often based on common sense rather than rigorous empirical study. This is surprising in view of the fact that pre-filling started more than two decades ago. In Australia, there is as yet insufficient quantitative data to make a carefully reasoned, empirical analysis. The qualitative assessment in this subsection will therefore focus on the likely impact of pre-filling on tax operating costs, initially from the perspective of administrative costs and, subsequently, in relation to compliance costs.

#### *Administrative costs*

In Australia, pre-filling could reduce tax administrative costs to the ATO via reduced needs for data matching, auditing, and tax-dispute resolution. At the same time, the uploading of pre-filling data to e-tax and the Tax Agent

Portal requires additional resources. Thus, the net saving in tax administration costs might not be as large as suggested in the literature. A more careful study to determine the reduction in tax administrative costs (if any) as a result of pre-filling is necessary.

#### *Compliance costs*

It is possible, conceptually, to identify a number of different ways in which pre-filling may reduce tax compliance costs. In the first place, taxpayer compliance costs may be reduced as a result of more individual taxpayers choosing to self-prepare and lodge their annual returns (with a commensurate reduction in the number using tax agents) as a direct result of the easier availability of data relevant to the completion of the return. Arguably, the benefit of the reduced fees that would need to be paid to agents would outweigh any increase in the value of time taken by self-preparers in submitting their returns. There may be some evidence that dependence upon tax agents is declining. The pilot pre-filling program was introduced in 2004/05 and expanded in 2007/08. From 2004/05 to 2006/07, there has been a steady decrease in the proportion of Australian individual taxpayers who use tax agents (Davidson, 2009: 6–7). However, since this declining trend had started as far back as 1999/2000, it is premature to conclude that pre-filling has resulted in a lower proportion of personal taxpayers who require tax agents to assist with tax affairs. Moreover, there is no evidence for, or against, the notion that taxpayer compliance costs have actually been reduced as a result of decreased dependence upon tax agents.

A second area in which there may potentially be compliance costs savings is in the reduced time taken by both self-preparers and tax agents in completing tax returns as a result of the more ready availability of data relevant to the return. Tables 1.1 and 1.2 in section 3.3 above suggest that the proportions of e-tax user and tax agents (who use pre-filling information) have been rising quite rapidly. In 2006/07, lodgements by e-tax grew by 20.6% to 1.9 million compared to the previous fiscal year, and overtook paper and telephone lodgements (1.4 million) (ATO, 2009a: 9). Pre-filling is likely to be taken up by younger personal taxpayers (who are more comfortable with e-tax) and personal taxpayers with simple tax affairs.<sup>20</sup> However, it may be over-optimistic to expect that this trend will continue unless pre-filling data continues to improve in terms of timeliness, comprehensiveness, availability, and accuracy.

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20 This is confirmed in the *Taxation Statistics* for 2006/07 where the ATO notes that “the proportion of taxpayers lodging returns [electronically] generally decreased with age,” although it is also noted that “by far the highest rates of growth [in electronic lodgements] were seen in those aged between 60 and 74” (ATO, 2009a: 9).



*Time savings*

Note that, under self-assessment, personal taxpayers who use pre-filling are still required to keep records as before and check their income tax returns carefully. Thus, time savings would not reduce record-keeping time<sup>21</sup> but would be limited to the completion and lodgement of income tax returns, and would therefore be relatively small in magnitude. In terms of time spent on completing and submitting income tax returns, there is a large difference between those personal taxpayers who self-prepare (2.2 hours annually) and those who use tax agents (1.8 hours annually) (Evans et al., 1997a: 77). Thus, pre-filling would be much more beneficial to self-preparers who lodge income tax returns on-line than those who lodge via their tax agents.

However the psychological benefits (knowing that one's own tax records are consistent with pre-filling data) may be substantial. It is also interesting to note that personal taxpayers' attitudes toward pre-filling may vary between different groups of taxpayers. Some taxpayers, mostly those with complicated personal tax affairs, may feel that the ATO knows little about them. Other taxpayers may be surprised to find that the ATO knows so much about their financial affairs.

*Three further points*

First, the provision of third party information for pre-filling requires resources by information providers and these costs have to be taken into account in assessing the benefits of prefilling

Second, the above discussion focuses on what are generally termed computational costs of tax compliance. Compliance costs also typically include planning costs as well as computational costs. There are no obvious theoretical reasons that pre-filling will reduce, or otherwise have any impact upon, the planning costs of tax compliance. Indeed, it is more than likely that pre-filling will have a neutral impact on tax planning costs.

Third, the opportunity exists for the ATO to gauge personal taxpayers' attitudes or perceptions toward pre-filling by including some appropriate questions in its annual taxpayer satisfaction survey.<sup>22</sup> Apparently some information about pre-filling will be published in future issues of the ATO's *Taxation Statistics*. It is therefore likely that the ATO will include specific questions about pre-filling in their future surveys, such as the Community Perception Survey.

21 Research indicates that actual record keeping is a relatively significant element of overall compliance costs for individual taxpayers—typically between 60% to 70% of the time spent by individuals on tax activities (Evans et al., 1997a: table 8.39).

22 At present, self-preparers can, in principle, provide feedback about their experience in using pre-filling in the annual survey of e-tax users but the results of these surveys relating to pre-filling are not yet publicly available.

#### 4.4 Means to improve

As discussed above, pre-filling requires timely, comprehensive, and accurate data from employers and financial institutions, preferably on-line. Given the current legislation governing the provision of pre-filling data to the ATO, the long-term viability and success of pre-filling will depend crucially on the voluntary efforts of providers of legislated data to submit data to the ATO on or before their deadlines. In the 2007/08 federal budget, the (then) Coalition government announced the New Business Intensive Assistance Program, which aims, among other things, to assist small businesses in Australia to report electronically (Costello, 2007). The program provides AU\$40 million over four years to fund individually-focused advice and assistance to new business. This includes assistance in registering with the ATO's business portal and completing the Business Activity Statement.

In addition, the ATO is actively engaging with the business sector in its pre-filling client contact program (Bland and Clarke, 2009). The principal aim of this program is to work with employers and investment bodies to encourage:

- early lodgement of payment summary annual reports (by July 28) and annual investment income reports (by August 8);
- on-line lodgement, using Electronic Commerce Interface (ECI); and
- on-line lodgement of TFN declarations and quarterly TFN reports.

A comparison of data received by the ATO via ECI as at October 31, 2007 and at October 31, 2008 seems to indicate that the ATO's pre-filling client contact program has been quite successful in achieving its aims (Bland and Clarke, 2009).

Another way to improve the program is to expand pre-filling beyond e-tax. At present, pre-filling is only available to personal taxpayers lodging on-line or personal taxpayers using tax agents. Making pre-filling available in paper form would be beneficial to those elderly personal taxpayers whose tax affairs are simple but who are not confident enough to lodge their income tax returns on-line. The availability of pre-filling data in paper form may reduce the need for those taxpayers to engage tax agents. This could then also have an impact on reducing the aggregate tax compliance costs. It would also have the effect of expanding (indefinitely) the current window of availability of the pre-filling service.

#### 4.5 Conclusions

The pre-filling initiative is partial and still at a very early and experimental stage in Australia. Moreover it is reactive (in the sense that the taxpayer or tax agent has to consciously engage with it) rather than proactive (as in the



Nordic countries where taxpayers receive the completed returns for checking or acceptance). Hence it would be premature and inappropriate to compare pre-filling in Australian with that in the Nordic region countries, where the initiative has been running on a broader scale for a much longer period.

Notwithstanding these differences, any initiative designed to enable taxpayers to reduce compliance costs and to comply with their tax obligations more easily has to be welcome. But it is unlikely, in its current form, either to have a significant impact on the compliance or administrative costs burden or to represent a significant step in the direction of a return-free tax jurisdiction for many or even some personal taxpayers. Its proponents must ensure that its continuing roll-out and development is carefully managed so that commentators do not attach to it unrealistic expectations of its capacity to reduce compliance or administrative costs or simplify the tax system that cannot be met in practice. Above all, there is a need for evidence on its impact to be systematically gathered, analyzed, and published.

Finally, such tax administrative initiatives critically depend, for their ultimate success, on the full support of political masters. As noted at the outset of this chapter, the Australian experiment with pre-filling appears to have such high-level support. In the Budget of May 2010 the Treasurer, Wayne Swan, fully endorsed the “flick and tick” (pre-filling) approach to personal tax returns argued for so strongly in the Henry Review delivered to the Government at the end of the previous year (Australian Government, 2010). However, contemporaneous actions of the Government, in ruling out others of the Henry Review’s recommendations that help to buttress this pre-filling approach, may to some extent dilute the ATO’s capacity to extend the pre-filling experiment as far in the direction of its Nordic and other counterparts as might otherwise have been expected (Evans and Tran-Nam, 2010).

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Chapter 2

# Belgium

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<sup>1</sup> I wish to thank Yves Cappelier, Vincent Pechon and Christian Valenduc, from the Ministry of Finance, for their help and information provided.

## 1 Introduction

Since 2003, Belgian taxpayers have been allowed to file their personal income tax returns on line. Since 2005, these electronic personal income tax returns have been partially prefilled. The main objective of the government is not the pre-completing itself but to obtain a single electronic fiscal file for each taxpayer in the medium term. The pre-completing can rather be considered as an incentive for the citizen to use the electronic tax returns.

The number of prefilled tax returns submitted by taxpayers has been increasing steadily, from 575,005 in 2005 to 1,712,916 in 2008, 27.4% of the total number of individual tax returns in Belgium in 2008. Parallel to this evolution, the number of prefilled items is increasing (see section 4) as data, especially those provided by private companies, become electronically available.

Because the objective is to reach a higher ratio of electronic returns, surveys have been conducted and technical improvements have been introduced in order to increase the chance of reaching the objective of 2 million electronic tax returns in 2009 and even more in the following years. By September 29, 2009, 1,967,986 Belgian income tax returns had been electronically submitted (more than 500,000 tax returns are still expected).

The outline of the chapter is as follows: section 2 explores the reasons for the failure of a first experiment with prefilled tax returns, section 3 explains the objective of the second, successful, experiment, section 4 describes the first years of the program, section 5 summarizes the results of two surveys of taxpayers, and section 6 concludes with a description of planned future developments.

## 2 First experiment abandoned

In 1995, a first experiment with prefilled tax returns was initiated. The objective of that first experiment was to simplify the procedure for taxpayers. Given the available prefilled information, the administration also included the amount of income tax to be paid in the prefilled tax return. This second objective was particularly ambitious in a country where the usual interval between filing a tax return and information about the amount of tax to be paid is about eight months.

As a test, the first experiment targeted only the income of pensioners and was in the form of paper tax returns. After one year, the experiment was abandoned because, even with taxpayer profiles as simple as those of pensioners, the complexity of the Belgian tax system and the unavailability of some data when prefiling the tax return (income of the spouse, income on movables, foreign pensions and so on) made it too difficult to establish a correctly prefilled tax return. It thus made no sense to continue.

### 3 The objective of the second experiment

In 2003, the complexity of the Belgian system was still the same but there was widespread access to the Internet and the availability of data to the tax authorities had been improved. Furthermore, a new objective had been defined, leading to the introduction of an electronic tax returns program in 2003 with prefilled items from 2005. The new objective of the government is, in the medium term, to get a single electronic fiscal file for each taxpayer, called My Minfin, with all fiscal dimensions included: income tax, VAT, custom duties, and so on. And this objective is part of a larger project of developing e-government in order to simplify administrative procedures for the citizens. The federal public service (FPS) Technologie de l'Information et de la Communication (Fedict) was created for that purpose and helps other FPS entities develop electronic services.

A first step in the direction of electronic filing was made through the scanning of all paper tax returns. The taxpayers completed paper tax returns set out in the form of a grid and sent it to the administration where it was read by a scanner that transformed the data in an electronic file. The paper tax returns could not be prefilled because the printing of tax return forms are subcontracted to a private company and confidentiality rules would not allow it.

A second step was made through a program of voluntary on-line filing called "Tax-on-web" ([www.taxonweb.be](http://www.taxonweb.be)). In 2003 (2002 incomes) and 2004 (2003 incomes), the number of electronic tax returns was disappointing: 57,727 in 2003 and 168,818 in 2004, out of more than 6 million personal income tax returns. The development of the application grew step by step: in 2003, only wage earners, the retired, and the unemployed had access; from 2004 on, accountants mandated by taxpayers to file on their behalf, the self-employed, and civil servants also acquired access.

In order to encourage taxpayers to file their personal income tax returns on line, several advantages have been added to the electronic tax return that are not available to those individuals filing paper tax returns:

- prefilled items, when the administration has access to the required information in an electronic form (all salaries and pensions, tax deductions such as retirement savings or gifts, real estate, prepayments, etc.);
- on-line help system to assist taxpayers through the different steps of the process with an alert when incoherent information is filled in;
- e-mail sent to taxpayers five days before the submission deadline if their personal income tax return is not complete;

- an extension of four months to file the tax returns (for mandated accountants only, see below);
- ability to estimate how much your tax return payment will be (amount to pay or to be refunded), for information only (not binding on tax authorities);
- acknowledgment of receipt of the electronic return from the tax administration;
- ability to follow on-line the steps of the treatment of one's tax return (receipt, verification of information, data encoded in the computing program of the ministry of finance, and so on).

In Belgium, prefilling tax returns is thus seen as a means rather than an objective.

## **4 The first years of the program**

### **Who can file the electronic prefilled tax returns?**

In 2004, self-employed workers had no access to Tax-on-web but, since 2005, nearly all taxpayers may turn to it. The few exceptions are those filing the tax returns of a deceased person and spouse, and married couples who divorced during the fiscal year.

There are three types of users: citizens, civil servants, and mandated accountants; and the program is adapted to each type. Citizens may, of course, file their personal income tax return on line themselves as they do for the paper tax return. Secondly, citizens may go to local tax offices and ask civil servants to file their tax return. This happens most of the time when they cannot file it by themselves because of the complexity of the income tax law (they are afraid to make a mistake), because they do not speak one of the national languages (French, Dutch, and German) sufficiently well, or because they are not able to read and understand the documents. This service has always been available during the period of filing (May to June), even for paper tax returns. All filing by civil servants is now done on line and by using "Tax-on-web for civil servants," the administration provides customer service of higher quality with less waiting time, an estimated amount of tax due, and a receipt. Finally, taxpayers may mandate an accountant to file their tax return. Today, most of these accountants use the on-line program thanks to an intense collaboration between the accountants' federations and the tax authority. They can upload several income tax returns and attachments of their clients at one go.



### How to access the program?

To access the program, users must identify themselves on the website created by the Ministry of Finance ([www.taxonweb.be](http://www.taxonweb.be)), using any personal computer. Two alternatives exist to do so: an access code (Token) or an electronic authentication. Use of electronic authentication is possible when a taxpayer wishing to use Tax-on-web has [1] an electronic identity card (eID), [2] an electronic card reader, and [3] the appropriate application installed on the computer. Since the end of 2009, all taxpayers, including foreign taxpayers, have an electronic ID. The card reader is free as the municipalities distribute it during information sessions or events about the eID organized by the Ministry of Finance or the Ministry of the Interior. It costs at least 15 Euros otherwise.

The access code is an alternative to the electronic authentication. Taxpayers need to register on the federal portal ([www.taxonweb.be](http://www.taxonweb.be)) and ask the administration for an access code that they receive by post. Once identified, the user downloads the application. The software is free and can be adapted to all types of computers and systems.

### What is the procedure for the user?

Once taxpayers have entered the on-line application, thanks to the access code or the electronic authentication, they can work on screens very similar to the preparatory document of the paper form. The taxpayer needs to include the missing information or to correct the prefilled information and possibly to scan and attach justificatory documents. This last step is not mandatory. If the documents are not scanned, the taxpayer has to make them available to the administration if he is audited.

The user may ask the application to calculate the likely amount of income tax to be paid or to be refunded and to test different ways to reduce the amount to be paid. For instance, one may reduce taxes by shifting some tax exemptions from the husband's income to the wife's income when a couple files a joint tax return.

It is possible to stop the procedure at any time, to save the data, and to return to work later on. The tax return has to be submitted electronically when the user estimates that it is completed. If the user does not click on the button "Submit," the administration cannot see the income tax return. It is considered as not being sent. At the end of the procedure, when the form has been submitted correctly, the user gets an acknowledgment that the return has been filed.

Once they have used the electronic return once, taxpayers may choose two options. First, they may choose not to receive the paper form anymore. Second, for the following years, they may ask to receive an e-mail five days before the income tax deadline to remind them when their return is not completed.

### **What information is pre-completed?**

The quantity of prefilled information is increasing each year. In 2005, only the personal data (address, marital status, and so on) and the anticipated income tax payments were prefilled. In 2006, this was extended to the incomes of civil servants and pensioners. Since 2007, all information provided electronically by administrations, employers, or financial institutions is prefilled. The condition to prefill the tax return is simple: the prefilled data must be originally available to the fiscal administration in an electronic format. As a consequence, the degree of pre-completion depends on the type of taxpayer and the information available electronically; two taxpayers whose tax profile is identical except for the financial institution they deal with can receive returns prefilled differently.

Companies and financial institutions are encouraged to make efforts towards increased electronic information exchanges. Since 2009, electronic information exchange is compulsory for most incomes. The first cooperating administrations were the National ID register,<sup>2</sup> the Crossroads bank for Social Security,<sup>3</sup> and the Crossroads bank for Enterprises.<sup>4</sup>

### **What are the results of using on-line prefilled tax returns?**

Table 2.1 shows the evolution of the number of on-line tax returns filed between 2003 and 2008, according to the type of user. The category of civil servants shows the greatest increase. Two main elements explain this. First, they do not have the choice between on-line and paper filing. Second, taxpayers more often turn to that service since the paper form has been arranged in a grid so it can be scanned. The paper tax return is indeed less easy to complete since this change because the figures need to be entered in the grid with codes referring to categories of incomes or expenditures rather than words. The category of mandated accountants also shows a significant increase, reflecting the good results of the cooperation between the tax administration and the accountants' federations. Citizens are less easy to convince and the efforts of the administration should be concentrated on this category. The survey of 2008 (see below) is one action that it has taken as a result of this observation.

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- 2 The National ID register contains, among other items, the following information about for each citizen: name, surname, place and date of birth, nationality, address, occupation, civil status. More items may be added as the use of ID cares develops.
  - 3 Thanks to integrated electronic processes, the Crossroads bank for Social Security contains all information needed by the social security offices for the calculation of all social security contributions and of all salary and working-time-related social security benefits. It is collected only once from the employers, at the moment that one of the following four types of events occurs: the beginning of an employment relationship, the three-monthly payments of social security contributions, the occurrence of a social risk, and the end of an employment relationship.
  - 4 The Crossroads bank for Enterprises is a register that stores all basic data regarding enterprises and their individual business locations.

**Table 2.1: Number of on-line tax returns filed, 2003–2008**

	2003	2004	2005	2006	2007	2008	2009*
Citizens	57,727	92,664	130,319	160,253	212,541	303,382	681,813
Token				156,519	193,873	241,679	418,611
eID				3,734	18,668	61,703	263,202
Civil servants	—	26,922	193,050	439,605	580,199	725,614	947,712
Mandated accountants	—	49,232	251,636	422,154	564,512	683,920	338,461**
<b>TOTAL</b>	<b>57,727</b>	<b>168,818</b>	<b>575,005</b>	<b>1,022,012</b>	<b>1,357,252</b>	<b>1,712,916</b>	<b>1,967,986</b>

Notes: \* to September 9, 2009; \*\* open until October 31.

Source: Personal communication from an anonymous civil servant in the Belgian ministry of finance.

### What does it cost the administration?

The development of prefilled income tax returns was part of a larger project and no cost-benefit analysis has been carried out for this specific feature of the program and no distinct budget is available. Furthermore, the administration confesses that “allocating money towards electronic applications was rather easy”<sup>5</sup> since improving e-government processes was one of the main goals of the Belgian government as a part of the so-called Copernicus reform. Nonetheless, the administration claims, on the benefits side of electronic tax returns, savings of about €500 million (US\$677 million) on postal expenses, less need for stocking space, less need for management controls, and more transparency.

On the costs side, we have no figures but we know that the costs are essentially due to the applications developed by private companies, the investments in hardware, the training of civil servants, and the advertisement campaigns.

## 5 The main results of the taxpayers’ surveys

In order to increase the benefits, information on the needs of the users was collected through surveys of Tax-on-web users and face-to-face meetings. Two main surveys have been carried out: *User Awareness: Tax on Web* (Deloitte, 2005); and *Étude de la connaissance de l'application “Tax-on-web” et des éléments incitateurs à son utilisation* (Dedicated Research, 2008). The first was a survey of mandated accountants, the second, a survey of citizens.

5 Source of quotation and other information in this section is personal communication from an anonymous civil servant in the Belgian ministry of finance.

### The survey of mandated accountants

In 2005, 820 accountants answered the questionnaire. Each accountant had filed between 1 and 750 returns in 2004, of which 62.2% were filed on-line. Mandated accountants can use the electronic income tax return for their clients. Today, 95% of the accountants' offices file electronically.

The accountants indicated they were informed of the possibility of on-line filing through various media, as shown in table 2.2 below. To the question "Do you plan to make a larger use of the electronic tax returns in 2005?" 91.7% answered "Yes." To the question "Would you advise your colleagues to use the electronic tax returns?" 83.3% answered yes. The global satisfaction index is lower than 6/10 for 16% of the respondents, higher than 7/10 for 38%, and 10/10 for 5%.

The main advantages to using Tax-on-web given by the mandated accountants are: the longer delay to file the tax returns (21.8%); the acknowledgment of receipt sent by the administration (18.07%); the availability of the system 24 hours a day, 7 days a week (16.04%); fewer corrections and meetings with the administration afterwards (10.53%); or lower postal costs (8.48%).

The main reasons suggested by the accountants to explain why colleagues do not use the electronic prefilled tax returns are: insufficient knowledge of the advantages of the on-line filing (53.1%); distrust in the confidentiality of the data on the internet (35.6%); unclear identification procedure (33.8%); too little communication to encourage the on-line filing (27.8%). As we can see, except for the second reason, the administration has the possibility of improving the system. In three years, more than 6,000 mandated

**Table 2.2: How accountants were informed about on-line filing (percent)**

Type of media	
Accountants' federations	53.4
Newspapers and specialized reviews	36.8
Federal website	25.4
Radio and television	16.9
Information sessions organized by the Ministry of Finance	7.8
Information or chat on internet	6.9
Other	6.6
Advice from another person	6.1
Search engine	1.3
Posters	0.7

Note: Percentages sum to more than 100% as information may have been obtained from more than one medium.

Sources: Deloitte, 2005.

accountants participated in information sessions about how to use Tax-on-web. The administration organized these sessions across the country to meet this important target group face-to-face.

### **The survey of citizens**

Five years after the start of the Tax-on-web program, with 200,000 citizens out of 6 million filing their returns on line, the results were regarded by the administration as insufficient. With four million frequent Internet users (i.e., those older than 15 and surfing at least once a month), the potential for increasing the rate of electronic returns was seen to be great. Therefore, a survey was carried out in 2008 to understand what improvements were needed: 8,500 taxpayers with an Internet connection at home were surveyed by phone; about 12% agreed to answer the questionnaire, leading to a sample of 1,009 taxpayers. The taxpayers surveyed were classified according to their age, the social class they belong to, and the frequency with which they used the Internet. The main results of the survey are the following:<sup>6</sup>

- 86% of the surveyed taxpayers use the Internet at home several times a week, and 70% use it to make payments;
- 39% knew of the possibility of filing tax returns on line and this rate increased with the age and the frequency of use of Internet of the taxpayer and decreased with the social class;
- only 22% remembered having seen an advertisement for Tax-on-web and responses indicated the most effective media to be, in decreasing order, TV advertisements, information attached to the paper tax return, and newspaper articles;
- 33% could describe the exact objective of Tax-on-web (47% of taxpayers from higher social classes and 38% of heavy users of Internet);
- 11% had already used Tax-on-web, 6% had tried to use it but had abandoned the attempt, 39% had not used it, and the remaining 44% did not file their tax return themselves;
- among taxpayers that had never used Tax-on-web before, 35% intended to use Tax-on-web for their next tax return, with rates decreasing with age (from 46% to 23%), social class (from 39% to 26%) and frequency of use of the Internet (from 38% to 28%);

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<sup>6</sup> See Appendix: Detailed results of the survey of citizens (p. 34) for a description of the classifications and detailed results.

- the users of Tax-on-web evaluate their satisfaction with the program at a level of 8.4/10, with marks increasing with age and decreasing with social class (except for the lowest of the four classes), which is quite counterintuitive;
- 94% of the users of Tax-on-web would advise acquaintances to use it.

The main advantages to using Tax-on-web given by taxpayers are that it is easier (for 67% of the users), it is faster (23%), and it calculates the amount to be paid or refunded (20%). Surprisingly, only 6% of the users mentioned that Tax-on-web enables the taxpayers to choose the best formula in order to reduce the amount of tax to be paid (by shifting the tax exemptions between spouses, for instance). An important observation is that once a taxpayer has filed a tax return on line, he does not go back to the paper form the following years because of the advantages offered by the on-line application. The users of Tax-on-web were also asked what should be improved in the program. The results are shown in table 2.3.

Many reasons were given for not using Tax-on-web but the main answers are that the paper tax return is easier to use (21%), that taxpayers are used to the paper (14%), that they are afraid to make mistakes (13%), that it takes too much time (8%), that it is difficult to connect to the application, and that interruptions occur (6%). The non-users of Tax-on-web were asked what would encourage them to turn to the electronic tax returns. The

**Table 2.3: How could Tax-on-web be improved (percent)?**

AREAS SUGGESTED FOR IMPROVEMENT	
The procedure for the electronic signature	31%
The possibility to test Tax-on-web beforehand	30%
The conditions to open a Tax-on-web account	30%
The access to the Tax-on-web website	29%
The possibility to see a demo	25%
The saturation of the network	25%
The acknowledgment receipt	24%
The legibility of the screens	21%
The automatic assistance	20%
The validation of the tax return	19%
The assistance by phone	12%

Note: Percentages sum to more than 100% as more than one improvement could be put forward.

Sources: Dedicated Research, 2008.

**Table 2.4: What would encourage non-users to adopt Tax-on-web (percent)?**

AREAS SUGGESTED FOR IMPROVEMENT	
Getting assurance that the data are well protected	71%
Getting a tax reduction for the use of Tax-on-web	70%
Simplification of the process	68%
Receiving a user guide at home	66%
Hearing a better appreciation of Tax-on-web from acquaintances	60%
Getting the assurance that the amount to be paid and the delay are not affected	59%
Having access to assistance by phone in the evening and weekends	59%
Being sure that it is possible to fill the data in several times	54%

Note: Percentages sum to more than 100% as more than one improvement could be put forward.

Sources: Dedicated Research, 2008.

answers are summarized in table 2.4. Following these surveys, Tax-on-web has been adapted. For instance, a demo is now available and the network is less often saturated.

## 6 Planned future developments

The spreading use of the electronic ID for Belgians and foreigners (from 2009) will naturally increase the potential of Tax-on-web. Since September 2009, Tax-on-web has been extended to non-resident personal income tax returns. As more and more information is exchanged electronically between the tax administration and other administrations, companies, and financial institutions, the amount of prefilled information will increase steadily. The most important steps will come with increased availability of electronic information about personal assets.

To encourage the citizens to use Tax-on-web, more advertising campaigns are needed in addition to existing spots on radio and television, posters in the streets and town halls, and information sessions in municipalities. The impact of the latter is important because it is observed that the rate of on-line filing is higher in the municipalities where these sessions have been organized by the Federal Public Service<sup>7</sup> of Finance.

The main difficulties identified by the administration for the forthcoming developments are the threat to confidentiality and technical aspects (it is not possible, for instance, to simplify the identification procedure much more).

<sup>7</sup> Dutch: FOD Financiën; French: SPF Finances; German: FÖD Finanzen.

## Appendix Detailed results of the survey of citizens

### Explanation of tables

–36, 36–55, +55 refer to the age of the respondent.

SC1, SC2, SC3, SC4 is the social class to which belongs the respondent. At the end of the interview, each respondent had to say whether he thought he belonged to the “superior social class,” the “medium-high social class,” the “medium-low social class,” or the “inferior social class.”

**Heavy user** uses the Internet nearly every day.

**Medium user** uses the Internet at least twice a week.

**Light user** uses the Internet less than twice a week.

**DNK** = Does not know.

### Question 1: During the last month, how often have you used the Internet personally at home?

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium user	Light user
Nearly every day	63%	66%	62%	63%	68%	64%	59%	57%	100%	0%	0%
2–3 times a week	23%	26%	22%	21%	24%	22%	23%	21%	0%	80%	0%
Once a week	6%	3%	6%	8%	5%	6%	9%	3%	0%	20%	0%
2–3 times a month	2%	2%	3%	2%	1%	3%	3%	2%	0%	0%	26%
Once a month	1%	1%	2%	0%	1%	2%	2%	2%	0%	0%	17%
Less than once a month	4%	2%	5%	5%	1%	3%	5%	16%	0%	0%	53%
No answer/DNK	0%	0%	0%	0%	0%	0%	0%	1%	0%	0%	3%

### Question 2: Do you know Tax-on-web?

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium user	Light user
Yes	39%	32%	40%	42%	54%	41%	28%	17%	44%	36%	9%
No	61%	68%	60%	58%	46%	59%	72%	83%	56%	64%	91%



**Question 3: Do you remember having seen one or more advertisements for Tax-on-web?**

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium user	Light user
Yes	22%	19%	25%	19%	29%	20%	17%	14%	22%	24%	9%
No	76%	80%	73%	79%	70%	76%	81%	86%	76%	74%	90%
No answer/DNK	2%	1%	2%	3%	1%	4%	2%	0%	2%	2%	1%

**Question 4: Could you explain what Tax-on-web is?**

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium user	Light user
To fill the tax return	33%	25%	37%	34%	47%	35%	22%	14%	38%	29%	7%
To give information on taxes	1%	2%	1%	2%	1%	2%	2%	0%	2%	1%	0%
Other	2%	2%	1%	2%	2%	2%	1%	1%	2%	2%	0%
No answer/DNK	3%	3%	2%	4%	3%	3%	2%	2%	2%	3%	1%
Do not know of Tax-on-web	61%	68%	60%	58%	46%	59%	72%	83%	56%	64%	91%

**Question 5: During the last 5 years, have you used or tried Tax-on-web?**

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium user	Light user
No	39%	31%	38%	46%	43%	35%	41%	32%	36%	45%	36%
Yes	11%	7%	12%	14%	11%	16%	10%	4%	13%	10%	1%
Tried but gave up	6%	4%	7%	6%	10%	6%	3%	3%	7%	5%	0%
No answer/DNK	0%	0%	1%	0%	0%	0%	0%	1%	1%	0%	0%
Do not fill themselves	44%	57%	43%	34%	35%	43%	47%	61%	43%	40%	62%

**Question 6: You have never used Tax-on-web before, but do you intend to use it for your next tax return?**

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium user	Light user
Certainly	9%	7%	13%	4%	10%	9%	8%	8%	13%	3%	0%
Probably	26%	39%	25%	19%	29%	26%	23%	18%	25%	27%	28%
Probably not	20%	19%	22%	19%	19%	19%	22%	23%	21%	20%	16%
Certainly not	40%	31%	35%	51%	35%	44%	42%	41%	34%	48%	48%
No answer/DNK	5%	4%	5%	7%	7%	2%	5%	10%	7%	2%	8%

**Question 7: On a scale from 1 (low) to 10 (high), what is your degree of satisfaction with Tax-on-web?**

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium + Light users
10	20%	7%	18%	28%	10%	21%	32%	25%	21%	16%
9	20%	27%	20%	17%	20%	28%	5%	0%	18%	24%
8	41%	46%	40%	42%	47%	37%	42%	50%	44%	36%
6–7	15%	20%	18%	8%	17%	14%	11%	25%	13%	20%
4–5	1%	0%	2%	0%	3%	0%	0%	0%	0%	4%
1–3	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
No answer/DNK	3%	0%	2%	6%	3%	0%	11%	0%	4%	0%

**Question 8: What was your motivation to use Tax-on-web?**

	Total	–36	36–55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium + Light users
It is easier than paper form	67%	87%	56%	72%	73%	61%	74%	50%	66%	68%
It is faster than paper form	23%	27%	24%	19%	30%	21%	16%	25%	25%	16%
You can estimate the amount due or to be refunded	20%	27%	18%	19%	23%	12%	26%	50%	14%	36%
It is trendy, modern	8%	0%	13%	6%	17%	2%	5%	25%	9%	8%
I like using the Internet	8%	7%	9%	8%	10%	7%	11%	0%	7%	12%
I heard positive comments	6%	13%	4%	6%	3%	9%	5%	0%	6%	8%
It uses less paper, is more ecological	6%	0%	11%	3%	10%	7%	0%	0%	7%	4%
It is possible to try options to pay less tax	6%	7%	9%	3%	3%	12%	0%	0%	6%	8%
It helps you to introduce the correct figures	4%	0%	7%	3%	3%	5%	0%	25%	6%	0%
Others	9%	7%	11%	8%	3%	16%	5%	0%	10%	8%
No answer/DNK	1%	7%	0%	0%	0%	2%	0%	0%	1%	0%

**Question 9: What was your motivation *not* to use Tax-on-web?**

	Total	-36	36-55	+55	SC1	SC2	SC3	SC4	Heavy user	Medium user	Light user
The paper form is easier	21%	24%	15%	27%	18%	23%	22%	21%	21%	23%	8%
I am used to the paper form	14%	15%	13%	14%	19%	11%	12%	8%	14%	14%	12%
It is complicated/I am afraid to make mistakes	13%	7%	13%	15%	11%	11%	18%	13%	11%	16%	8%
It takes too much time	8%	8%	9%	6%	8%	10%	6%	8%	6%	10%	8%
Explanations are not clear	6%	8%	5%	7%	6%	5%	7%	8%	7%	6%	0%
Difficulties to connect, existence of interruptions	6%	6%	7%	5%	7%	6%	5%	5%	6%	5%	8%
I want to keep a paper copy for myself	5%	8%	2%	6%	5%	4%	6%	3%	4%	6%	0%
I did not know Tax-on-web	4%	6%	6%	2%	5%	1%	6%	10%	3%	4%	16%
It is not reliable	4%	1%	3%	7%	4%	4%	5%	3%	4%	5%	0%
I don't know what to do with justificatory documents	2%	4%	2%	1%	5%	1%	1%	0%	2%	4%	0%
I don't know what to do in case of a problem	2%	6%	2%	1%	3%	4%	0%	0%	3%	2%	0%
You need an electronic authentication	2%	0%	3%	1%	2%	4%	0%	0%	3%	0%	0%
I don't like the Internet in general	2%	0%	2%	3%	1%	1%	5%	5%	1%	2%	12%
I fear publicity of my personal data	2%	0%	2%	3%	1%	2%	5%	0%	2%	2%	0%
I thought it was not finalized	2%	0%	3%	1%	3%	1%	1%	0%	2%	2%	0%
I fear that the return is not registered	2%	1%	2%	2%	2%	0%	3%	0%	2%	2%	0%
Others	10%	14%	11%	7%	12%	7%	12%	10%	11%	10%	4%
No answer/DNK	18%	10%	22%	19%	12%	23%	21%	23%	18%	16%	28%

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Chapter 3

# California

by Brian Erard<sup>1</sup>

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<sup>1</sup> I thank Sean McDaniel of the California Franchise Board for his generous assistance in providing me with information about the ReadyReturn Program. I also thank François Vaillancourt for many helpful comments on an earlier draft of this paper. Unless specifically stated otherwise, any opinions expressed in this paper are those of the author and should not be attributed to the California Franchise Tax Board, the Fraser Institute, or any other person or organization.

## 1 Introduction

Taxpayers spend substantial time and money each year gathering documents, reading instructions, hiring tax assistance, and preparing their tax returns. The overall costs in time and expenses for US taxpayers of complying with their federal individual income tax requirements amounted to an estimated \$85 billion in tax year 2004, or 10.5% of federal individual income tax receipts (Slemrod, 2005). It has been suggested that some of these costs arise simply because government is not providing taxpayers with information it already has available to help them to complete their returns (Goolsbee, 2006). For instance, the Internal Revenue Service (IRS) receives detailed information from employers, banks, and other institutions about an individual's employment earnings, interest, dividends, pensions, Social Security benefits, unemployment insurance receipts, and distributions from Individual Retirement Accounts. Taxpayers also receive this information from the third-party providers, but they are required to transfer the details to the relevant line items of their tax returns themselves. Goolsbee (2006) estimates that in the United States individual taxpayers with relatively simple income tax circumstances accounted for about 52 million returns, or 40% of the annual federal filing population, in tax year 2003. This category includes taxpayers with no itemized deductions or credits (other than the Child Tax Credit and the Earned Income Credit),<sup>2</sup> including:

- 9.1 million single filers with no dependents and no income other than wages;
- 8.4 million filers, including married filers and filers with dependents, with no income other than wages;
- 21.1 million filers with some income other than wages from “withholdable sources” such as interest, dividends, pensions, social security benefits, unemployment insurance, and individual retirement accounts;
- 0.4 million filers receiving some capital gains distributions from mutual funds in addition to possibly having income from withholdable sources; and
- 13.4 million filers eligible for the Earned Income Credit with income only from withholdable sources or capital gains distributions from mutual funds.

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2 In the United States, those paying federal income tax are eligible for a Child Tax Credit of up to \$1,000 per qualifying child if their adjusted gross income is below a specified threshold. The Earned Income Credit is a refundable tax credit for working individuals and families with low to moderate incomes.

Goolsbee estimates that, if these taxpayers were able to use pre-filled returns from the IRS that already contained the relevant third-party information, they could achieve an average reduction in the cost of compliance of up to \$85 per year. This represents a meaningful saving, particularly for families with low to moderate levels of income. If all 52 million eligible filers were to participate, the aggregate estimated reduction in the burden of complying with income tax requirements would amount to \$4.4 billion. However, the actual participation rate for such a program may fall well short of 100%.

Pre-completed (or prefilled) tax returns either have been introduced, or have been experimented with, by a number of federal tax jurisdictions, including those in Australia, Belgium, Denmark, Spain, Sweden, France, Finland, and Norway. At the sub-national level, the Province of Québec recently launched a pilot prefilled return program in 2008. This report concerns a similar sub-national program in the United States: the California ReadyReturn program. The pilot prefilled return program was first introduced during the 2005 processing year to a sample of approximately 52,000 Californians filing state income tax returns who were deemed to have very simple returns. A full-fledged version of the program was rolled out during the 2008 processing year for the reporting of 2007 taxes. For that year, about 1 million taxpayers, representing 6.6% of the overall state return-filing population, were eligible to participate. The program was expanded in the following year so that over 1.9 million taxpayers were now eligible to participate. The following sections provide a description of the program, discuss some of the major issues that arise in its implementation, perform a preliminary assessment of its impact during the pilot years, and summarize some of the key lessons learned.

## 2 Overview of ReadyReturn

State income taxes in California are administered by the California Franchise Tax Board (CFTB). In an effort to reduce the burden of filing upon individual income taxpayers with relatively simple filing circumstances, the CFTB in 2005 introduced a pilot ReadyReturn program for the reporting of tax year 2004 state income taxes. Under this program, 51,850 taxpayers—approximately 0.4% of all California state taxpayers in that year—received an invitation to participate along with a prefilled tax return from the CFTB that was based on the wage and tax-withholding records provided to the state by their employers. If the information provided on the return was correct, participants could simply fill in their social security number, sign the return, and submit it either by mail or electronically over the ReadyReturn website for processing. Otherwise, they could use the website to modify their return and submit it electronically. Beginning in 2008, ReadyReturn was launched as a full-fledged program. The program was expanded in 2009 (returns for tax year

2008) so that over 1.9 million filers with relatively simple tax circumstances, or approximately 11.4% of California's roughly 16.7 million taxpayers, were eligible to participate. This section presents an overview of the evolution of the program since it was first introduced in processing year 2005 (returns for tax year 2004) through processing year 2009 (returns for tax year 2008).

## 2.1 The pilot years

The ReadyReturn program was first introduced by the CFTB on a pilot basis during processing year 2005 for those filing state individual income tax for tax year 2004. The objective of the pilot was to develop some preliminary information on program take-up and impact. Of particular interest was the degree of taxpayer participation, the degree to which the burden of compliance was reduced, and the efficiency of administration.

Participation in the pilot program was by invitation only. Beginning on February 15, 2005, the CFTB began mailing out invitations along with completed tax-year-2004 ReadyReturns to a sample of 51,850 taxpayers who were deemed to have very simple tax returns. To be considered for an invitation, a taxpayer had to meet the following criteria.

On the 2003 state tax return, the taxpayer must have:

- filed a resident tax return;
- used the single (unmarried) filing status;
- claimed no dependents;
- not been claimed as a dependent on another tax return;
- claimed the standard deduction;
- had income only from wages; and
- had only one employer (i.e., only one employer had filed a W-2 information return summarizing wages earned by the taxpayer).

Furthermore, the taxpayer must have:

- had no tax-year-2004 return on file as of the date the ReadyReturn was mailed;
- had no tax payments on file (other than source withholding by employers) as of the date the ReadyReturn was mailed;
- had fourth quarter 2004 wage data available from the Employment Development Department (which is in charge of payroll taxes and employer information reporting);
- had only one employer (only one W-2 form);
- had total wages less than or equal to the itemized deduction phase-out;
- had income indicating a filing requirement or a refund;
- had a California address on file; and
- met certain other internal administrative requirements.



From the pool of eligible taxpayers, a statistically valid sample of 51,850 were sent invitations to participate in the program with the objective of securing approximately 10,000 participants. A separate random sample of 31,500 eligible but uninvited taxpayers served as a control group. Those selected received an invitation by mail containing instructions on how to participate as well as a return that had been prefilled using W-2 records from the employer regarding wages paid and taxes withheld. The invitation letter was printed in English on one side and Spanish on the other. Slightly different versions of the letter were mailed to recipients who appeared to be owed a refund and recipients who appeared to have a balance due.<sup>3</sup> In both versions of the letter, the recipients were informed that their participation was optional.

The CFTB understood that some of the invitees would have had a change in their tax circumstances from tax year 2003 to tax year 2004. This generally did not preclude their participation in the pilot as they were able to make any necessary modifications to their return and file it electronically using a special ReadyReturn website operated by the CFTB. All tax changes associated with the modifications were computed on the return automatically. Typical modifications included:

- a change in name or address;
- a change in filing status;
- an addition to income;
- a claim for a deduction or a Renter's Credit;
- a voluntary contribution; and
- an election for an electronic refund or payment.

Alternatively, if the information on the return was correct, the taxpayer could fill in his/her social-security number on the pre-completed return, sign it, and mail it in. For taxpayers receiving a refund, the instructions emphasized that refunds would be processed in less than a week if filed electronically through the website but might take 4 to 6 weeks if filed by mail. Participants who filed electronically received a declaration control number that they were instructed to retain for their records along with a copy of the return, supporting documentation, and a signed electronic-return authorization form (form CFTB 8453-OL).<sup>4</sup> Copies of both the tax return and the authorization form could be printed from the website.

3 Samples of the letter and ReadyReturn are available on the CFTB website at [http://www.ftb.ca.gov/readyReturn/comments\\_05.shtml](http://www.ftb.ca.gov/readyReturn/comments_05.shtml).

4 To use the website, the taxpayer had to provide his/her last name, social security number, and the four-digit customer service number that was provided on the invitation letter. The signed electronic-return authorization form was not submitted electronically with the return but was instead retained by the taxpayer.

Owing to the timing of receipts of W-2 data on employee earnings and withholding from the state Employment Development Department, the invitation letters were mailed in two waves: 19,205 were sent on February 16, 2005 and 32,645 on February 23, 2005.<sup>5</sup> Follow-up letters were sent (on March 23, 2005 for the first wave and on April 4, 2005 for the second wave) to any recipients who did not yet have a tax year 2004 return on file.<sup>6</sup> Ultimately, 11,620 of the invitees elected to participate, representing a take-up rate of 22.4%. This exceeded the CFTB's expectation that 10,000 invitees would participate.

Based on positive results from the tax-year-2004 pilot program (discussed below in section 3), the three-member Franchise Tax Board voted unanimously on June 19, 2005 to implement ReadyReturn fully as a permanent program. The permanent program would have been open to up to one million taxpayers with projected participation growing to 230,000 by 2010. However, on July 19, 2005, Assembly Bill 139 (CH. 74) limited funding for the ReadyReturn program and mandated that it remain a pilot for tax year 2005.

The pilot program for tax year 2005 had one substantive difference from the prior year's program; namely, the mailing of the invitation letters was delayed until March 15 to allow more time for the receipt of wage information from employers. Delaying the mailing until this date resulted in the receipt of an additional 14 million wage records, thereby increasing the size of the pool of eligible taxpayers. However, there was a tradeoff. Since most taxpayers receive their W-2 forms from employers in January, the delay in sending out invitations increased the likelihood that an otherwise eligible taxpayer already would have filed his/her return. ReadyReturn invitations were sent to a randomly selected group of 50,820 taxpayers that included 2,782 prior-year program participants. To be eligible to receive an invitation, taxpayers had to meet requirements comparable to those used for the tax-year-2004 pilot program. A control group of 63,337 eligible but uninvited taxpayers was also randomly selected. This sample included 2,770 taxpayers who had participated in the ReadyReturn program during the prior year.

Given the later date for the mailing of the invitation letters, no follow-up letters were sent during this year of the pilot. As in the previous year, slightly different versions of the letter were sent to taxpayers who appeared

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- 5 CFTB receives its employer wage information from the state Employment Development Department (EDD). Employers are required to provide this information to EDD on a quarterly basis, with the fourth-quarter information due by January 31 of the subsequent year. Taxpayers typically receive their W-2 wage statement around this same time. However, there is a lag in CFTB obtaining the wage information from EDD. Usually, by mid-March CFTB has received details from about 95% of all W-2 forms.
  - 6 California individual income tax returns are normally due by April 15, although taxpayers automatically qualify for an extension until October 15.

to be owed a refund and those who appeared to have a balance due.<sup>7</sup> Both versions of the letter were revised for the second pilot year to emphasize the need for participants to make any necessary changes to the return, such as reporting additional income or claiming the Renter's Credit or Child and Dependent Care Expenses Credit. As of July 21, 2006, 10,581 of the invitees filed a ReadyReturn. This represents a take-up rate of 20.8%, slightly lower than the 22.4% rate of the prior pilot year.

## 2.2 The full-fledged program

Subsequent to the two pilot years, the ReadyReturn program was put on hold for a tax year as political issues played out (see section 6). However, beginning in processing year 2008 (tax year 2007), a full-fledged version of the program was rolled out state-wide. This version of the program differed from the pilot program in certain substantive ways, particularly with regard to the process for participating.

### *Processing year 2008*

For processing year 2008, a taxpayer was eligible to participate if he had only one employer in 2007, all four quarters of employer-provided wage information for 2007 were available to the CFTB, and the taxpayer had filed a resident tax year 2006 return with the following characteristics:

- single filing status;
- no dependents and not claimed as a dependent on another return;
- income from wages only;
- no special credits; and
- standard deduction claimed.

These eligibility conditions were similar to those of the pilot program but all eligible taxpayers were now permitted to participate. Moreover, the program was run on an “opt-in” basis under which an eligible taxpayer had to request a ReadyReturn rather than receiving an invitation containing the return in the mail. To request a ReadyReturn, the taxpayer could visit the ReadyReturn website to see if a return were available. If so, the taxpayer could view the return, print it out, and, if desired, modify it and file it electronically. Alternatively, the taxpayer could request a copy of an available ReadyReturn be delivered by mail by contacting the CFTB's toll-free interactive voice-response system. If a return was not yet available, for example because fourth-quarter wage information had not yet been received, taxpayers would need to check back at a later date to see if a return was ready. The opt-in approach was deemed

<sup>7</sup> Samples of the letters and ReadyReturns are provided on the CFTB website at [http://www.ftb.ca.gov/readyReturn/comments\\_05.shtml](http://www.ftb.ca.gov/readyReturn/comments_05.shtml).

to be more cost-effective than mailing ReadyReturns to all eligible taxpayers. There were also concerns that mass-mailings of paper ReadyReturns might have an adverse impact on electronic filing rates.

Marketing of the program was done using relatively cost-effective means such as through tax booklets, the CFTB website, the Voluntary Income Tax Assistance program, other state public assistance programs, and the media.

As with the pilot program, taxpayers whose circumstances had changed from the previous year were permitted to participate by making modifications to their ReadyReturns. Allowable modifications in processing year 2008 included:

- a change of address or contact information;
- a modification in the level of income;
- reporting additional sources of income;
- claiming itemized deductions; and
- claiming tax credits.

For processing year 2008, the CFTB (2007b: 2) estimated that approximately one million taxpayers would be eligible for the program and that approximately 30,000 would participate (3% of eligible taxpayers), with participation rates rising to 9% and 16% in the subsequent two years. In September 2008, the CFTB (2008b: 1) reported an updated statistic suggesting that approximately 730,000 taxpayers were initially eligible to participate and that 367,000 ReadyReturns were “readied,” meaning that the taxpayers had not already filed by the time fourth-quarter employment data was received and had not been excluded because of having multiple employers. Ultimately, 11,253 ReadyReturns for tax year 2007 were filed during processing year 2008, well short of the 30,000 projected. Three fourths of the participants reported they were due a refund on their returns and 72% of these taxpayers requested a direct deposit.

#### *Processing year 2009*

For the 2009 processing year, the program was expanded to make over 1.9 million taxpayers eligible to participate. For this year, taxpayers were allowed to participate even if they claimed on their resident tax year 2007 return:

- head of household filing status;
- up to five dependents; and/or
- the Renter’s Credit.

In addition, taxpayers could participate if they were claimed as a dependent on someone else’s return for tax year 2007. However, an income limitation

was introduced, so that single taxpayers with total income exceeding \$163,186 and heads of household with total income exceeding \$244,784 were not eligible to participate. As of the 2009 processing year, taxpayers have been able to sign up for an e-mail alert to let them know when their ReadyReturn becomes available. Statistics for the 2009 processing year indicate that 61,753 taxpayers filed a ReadyReturn for tax year 2008. This represents a dramatic increase from the 11,253 ReadyReturns filed during the prior processing year. However, it is important to keep this figure in perspective. In particular, the ReadyReturn participants represent only approximately 3% of all eligible taxpayers for processing year 2009 and only about one half of 1% of all state personal income tax returns filed during that year.

### 3 Profiles of taxpayers in the pilot program

This section presents profiles of taxpayers who were eligible for the ReadyReturn pilot program conducted during the 2005 and 2006 processing years, of participants in the pilot program, and of non-participants, based on a combination of survey findings and administrative statistics.

#### 3.1 Description of surveys

For each of the pilot program years, the CFTB performed surveys of invited participants and non-participants as well as members of the control group of eligible but uninvited taxpayers.<sup>8</sup> The survey of on-line users of ReadyReturn was offered over the Internet to all users at the completion of their on-line filing activity. Ultimately, there were 5,610 on-line users during processing year 2005 but the survey results for this year are based on responses received from a population of 5,571 users who had completed their returns by August 25, 2005. The survey results for processing year 2006 are based on responses from the population of 5,001 on-line users who had completed their returns by July 21, 2006. The survey questions were identical in both years and included 14 multiple-choice questions.<sup>9</sup> Space was also provided for participants to type in any additional comments.

For processing year 2005, taxpayers who mailed in paper copies of their ReadyReturns (“paper users”) and non-users of ReadyReturns were included in a common sampling frame for a mail-in survey. All of the roughly 6,000

8 The survey instruments are available on the CFTB’s website at <http://www.ftb.ca.gov/readyReturn/Surveys.pdf> for the 2005 processing year and <http://www.ftb.ca.gov/readyReturn/RRSurveysTY05.pdf> for the 2006 processing year.

9 Taxpayers who participated in the program in both years were informed on the survey for processing year 2006 that they did not need to answer the question about their experience filing with ReadyReturn as compared to their experience filing in the prior year.

paper users of ReadyReturns who were identified as of August 26, 2005 were sent a copy of the survey; it was also sent to a random sample of approximately 2,800 non-users. The recipients received a self-addressed, postage-paid envelope in which to return their completed survey. The survey included 16 multiple-choice and fill-in-the-blank questions as well as a space for providing additional written comments. However, respondents were asked to answer only questions relevant to their filing status and instructions were provided to inform users of paper ReadyReturns forms, non-users, and taxpayers who had not yet filed which questions they should answer. For processing year 2006, all users who were identified as of July 3, 2006 and a random sample of non-users were sent separate surveys that contained only those questions relevant for their situation. These questions were substantively unchanged from those asked on the survey for processing year 2005.<sup>6</sup>

For processing year 2005, a random sample of 15,000 of the 31,500 eligible but uninvited taxpayers from the control group were sent a mail-in survey. The recipients received a self-addressed, postage-paid envelope in which to return their completed survey. The survey included nine multiple-choice and fill-in-the-blank questions as well as a space for providing additional written comments. For processing year 2006, a sample of 5,002 taxpayers from the 63,337 members of the control group were sent a virtually identical survey. However, the composition of the recipients in this year was not well designed: the survey was sent to all 2,337 members of the control group who had participated in the ReadyReturn program during the prior year but were not invited for the current year, as well as to a random sample of 2,665 taxpayers from the remainder of the control group. My assessment is that, as a result of over-sampling ReadyReturn participants from the year before within the control group, statistics based on the raw survey responses are not likely to be representative of the control group as a whole. In particular, such statistics give too much weight to the responses of prior-year ReadyReturn participants and too little weight to the responses of prior-year non-participants.

Table 3.1 shows the sampling results for the surveys in the 2005 processing year. With the exception of the survey of on-line users, the response rates were relatively low, which raises the potential for non-response bias. In other words, there is uncertainty as to how representative the results are of the underlying populations. The comparable sampling results for the 2006 processing year are presented in table 3.2. Again, the response rates are relatively low for all but the on-line user survey, which raises the potential for non-response bias. This caveat should be kept in mind when interpreting the survey results.

The following discussion employs survey findings along with available administrative statistics drawn from the pilot program reports (CFTB, 2006a, 2006b) to summarize the characteristics of participants of the pilot program



**Table 3.1: Sampling statistics for CFTB's survey in processing year 2005**

Group	Population	Sample Size	Responses	Response Rate	Margin of Error*
On-line users	5,571	5,571	2,126	38%	1.67
Combined groups (those filing paper returns and invited non-users)	46,279	8,757	1,266	14%	2.72
Control group	31,500	15,000	1,616	11%	2.37
Total	—	29,328	5,008	—	—

Note\*: Margin of error represents the author's calculation of the maximum margin of error in percentage points for a population proportion based on the sample and population sizes.

Source: *ReadyReturn Pilot Tax Year 2004 Study Results* (CFTB, 2006a).

**Table 3.2: Sampling statistics for CFTB's survey in processing year 2006**

Group	Population	Sample Size	Responses	Response Rate	Sampling Error*
On-line users	5,001	5,001	2,160	43%	1.59
Users filing paper returns	5,452	5,452	853	16%	3.08
Invited non-users	40,367	5,000	314	6%	5.51
Control Group**					
Prior year users	2,770	2,770	755	15%	N/A**
Prior year non-users	60,567	2,232			
Total	—	20,455	4,082	—	—

Note\*: Margin of error represents the author's calculation of the maximum margin of error for a population proportion based on the sample and population sizes.

Note\*\*: Raw sample is unlikely to be representative of control group due to the over-sampling of prior year ReadyReturn users.

Source: *Ready Return Pilot Preliminary Studies for Tax Year 2005* (CFTB, 2006b).

as well as non-participants. The survey findings are generally quite similar for the two pilot-program years. Given this similarity in survey results, the discussion of survey findings focuses on the results of the 2005 processing year surveys except where otherwise indicated.<sup>10</sup>

<sup>10</sup> My decision to focus on the results from the 2005 processing year survey findings is driven partly by concerns over the representativeness of the control group results for the subsequent processing year. As discussed in section 3.1, prior-year ReadyReturn users in the control group were over sampled during the 2006 processing year, with the effect that the available raw statistics from the survey place undue weight on the responses of those taxpayers.

### 3.2 Profile of eligible taxpayers

The ReadyReturn pilot program was restricted to taxpayers who were deemed to have very simple tax circumstances based on current employer information reports and prior-year filing behaviour (as discussed in section 2.1). In particular, the focus was on taxpayers who appeared:

- to be single with no dependents;
- to have only one employer;
- to have income only from wages;
- to receive the standard deduction (rather than an amount based on deductions that are itemized on a special schedule); and
- not to have been claimed as a dependent on another return.

Administrative statistics and survey results for the control group provide some further details on the eligible population. As of July 21, 2006, 87% of the control group population had filed their 2005 tax return. Among these filers, administrative statistics indicate that:

- the median adjusted gross income was \$33,842;
- 73% received a refund, with a median amount of \$103;
- 26% of the refunds were paid via direct deposit;
- 26% had a balance due, with a median amount of \$105;
- 41% filed electronically; and
- 40% had filed electronically in the prior year.

Relative to the general filing population, this represents only a slightly lower median level of adjusted gross income (\$33,842 compared to \$34,128). This raises an important point; namely, that a simple return is not necessarily a low-income return. Indeed, the highest-adjusted gross income among those taxpayers invited to participate in the program was \$143,139, an amount that falls well within the top decile of all taxpayer incomes.

Relative to the general filing population, the above statistics indicate that eligible taxpayers had a higher refund rate (73% compared to 65%) and a substantially lower electronic filing rate (41% compared to 60%).<sup>11</sup> The high electronic filing rate within the general population is partly the result of a California requirement for all tax practitioners who prepare more than 100 returns each year to file all returns electronically. Whereas about 65% of the general population has their return prepared by a tax professional in a given tax year, only about 40% of taxpayers with very simple returns rely on professional assistance.<sup>12</sup>

11 The median adjusted gross income for the general population was taken from CFTB, 2009, while the refund rate for the general taxpayer population is taken from CFTB, 2008a: 29.

12 The source of the 65% figure is CFTB, 2007; of the 40% figure is CFTB, 2006b: 18.



Based on the 2005-processing-year survey of control-group members, 60% indicated that they would be interested in using ReadyReturn after reviewing a brief description of the service, 19% expressed no opinion, and 21% indicated they would not be interested in participating. This appears to indicate a rather high level of interest in the program among eligible taxpayers. However, this finding is tempered to some degree by the much lower actual participation rate of 22.4% among the invited group in that year. Nonetheless, one should keep in mind that this was a new program that was supported by little, if any, advertising. Over time, one would expect participation to improve as familiarity with the program grows.

Not all taxpayers and businesses feel that the government should be in the business of providing prefilled tax returns to taxpayers (as discussed further in section 6). Among those control-group members that were surveyed, 50% indicated that they were in favour of the government providing such a service, 38% stated that they had no opinion, and the remaining 12% were against it. The preferred return preparation method among control group respondents can be broken down approximately as follows:

- 48%: prepared by a tax practitioner/accountant;
- 32%: self-prepared using paper return;
- 10%: self-prepared using a government website;
- 7%: self-prepared using software or a non-government website; and
- 3%: other.

### 3.3 Profile of ReadyReturn participants

Overall, the surveyed ReadyReturn participants overwhelmingly reported finding the pilot program easy to understand (on-line users: 97%; paper users: 99%) and more convenient than their prior-year filing method (on-line users: 96%; paper users: 95%). The vast majority of respondents reported that they were either very satisfied (on-line users: 75%; paper users: 76%) or satisfied (on-line users: 24%; paper users: 22%) with the program and that they would use the program again (on-line users: 99%; paper users: 98%).

Actual evidence suggests a lower repeat-usage rate than that indicated by the survey responses to the question about using the ReadyReturn program in the future. During the 2006 processing year, 2,782 taxpayers who had participated in the ReadyReturn program the year before were again invited to participate. Of these taxpayers, 55% participated during the second year. The CFTB suggests that the later implementation date and changes in the taxpayers' situations may explain some of the discrepancy between the more than 98% of surveyed participants who said they would participate in the program again and the 55% of invited participants who actually did participate for a second time.

Administrative statistics indicate that, relative to non-participants, ReadyReturn participants in processing year 2006:

- had a higher median adjusted gross income (\$36,825 versus \$33,198);
- were less likely to be due a refund (66% versus 73%);
- were more likely to have a refund paid via direct deposit (28% of those due a refund versus 25%); and
- were less likely to have filed electronically during the prior tax year (35% versus 40%).

Among ReadyReturn participants, on-line users had a higher median adjusted gross income (\$37,618) than those filing paper returns (\$36,065), and they were relatively more likely to be due a refund (79% compared to 55%). Moreover, when an on-line user was due a refund, it tended to be for a larger amount (median amount of \$91 compared to \$67) and the taxpayer was more likely to have the refund paid via direct deposit (49% compared to 10%).

Survey results from processing year 2005 indicate that, relative to the control group, ReadyReturn participants were more likely to perceive that the program would make them feel less anxious about filing their return (88% of on-line users and 75% of those filing paper returns compared to 40% of control group respondents). The participants were also relatively more likely to respond that they were in favour of the government providing such a service (98% of electronic users and 85% of those filing paper returns compared to 50% of control group respondents).

When asked for the main reasons they chose to participate (respondents could choose more than one answer), the responses broke down as follows between those filing on line and those filing paper forms:

- as a result of the invitation: 85% on-line, 70% paper;
- easier than how filed last year: 50% on-line, 60% paper;
- thought it would save time: 60% on-line, 62% paper;
- thought it would save money: 25% on-line, 20% paper;
- thought it would result in a faster refund: 38% on-line, 20% paper; and
- because the TeleFile program was no longer available: 18% on-line, 21% paper.<sup>13</sup>

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13 Under the TeleFile program, taxpayers who qualified to file an “EZ” return for resident single and joint filers with no dependents could call a special CFTB phone number 24 hours a day during the filing season and enter their tax return information over a touch tone phone. This service was discontinued in October 2004.

An important issue for the ReadyReturn program is the security of taxpayers' information, particularly the return information that is made available over the ReadyReturn website. The CFTB (2007b: 7) reports that it employs the following measures, among others, to ensure the security and privacy of taxpayer data:

- a strategy of “Defense in Depth” that relies upon multiple layers of security to resist all classes of attacks;
- a combination of IT security technologies such as routers, firewalls, switches, and intrusion-detection devices to protect taxpayers' information;
- industry-standard Secure Sockets Layer (SSL) protocol with 128-bit key length to ensure a secure connection between a taxpayer's computer and the ReadyReturn application;
- a requirement to supply shared secrets for on-line authentication that only FTB and the taxpayer would know;
- in the case of paper ReadyReturns, which are requested by taxpayers over the phone and mailed to them, the taxpayer's Social Security Number is left off of the pre-completed return;
- strict internal policies for protecting taxpayer privacy: only staff with a right to know and need to know may gain access to taxpayer data.

For access to tax information on the ReadyReturn website, a participant was required to provide his/her social security number as well as the access code that was provided on the invitation letter. To explore how comfortable ReadyReturn clients were with the security provisions of the program, participants were asked whether they felt that ReadyReturn kept their information secure. Only about 1% of on-line users and 4% of those filing paper forms responded “No” but another roughly 25% of on-line users and 30% of those filing paper forms responded that they had “No Opinion.” Presumably, participants would be the ones most likely to respond affirmatively to such a question as they actually chose to use the service. Therefore, it seems reasonable to expect that these figures overstate the comfort level within the overall eligible population to some extent.

Participants were able to make changes on the ReadyReturn website if the information provided on the ReadyReturn was not an accurate reflection of their tax circumstances. In practice, 96% filed their ReadyReturns in tax year 2004 as is, without making any modifications, while 3% added income to their returns and one half of 1% reduced the income on their returns.

Administrative statistics based on the tax year 2005 ReadyReturn program provide details on the prevalence of other types of return modifications:

- less than 1% changed their filing status from single to married joint, married separate, or head of household;
- approximately 3% of those participating on line changed claimed the non-refundable Renter's Credit, while less than 1% of those filing paper returns did;
- only one participant claimed the Child and Dependent Care Expenses Credit.

Thus, for the most part, participants confirmed that the information available to the CFTB and printed on their ReadyReturns was an accurate representation of their tax situation.

### **3.4 Views of non-participants**

When asked the main reason they declined to participate in the pilot program of processing year 2005 (respondents could choose more than one answer), non-participants' responses broke down approximately as follows:

- 29%: preferred to use a tax preparer/accountant;
- 22%: already filed before receiving invitation;
- 11%: were not comfortable receiving return completed by the government;
- 10%: needed to file a federal return first;
- 9%: did not think filing returns over the Internet is secure;
- 8%: did not have time;
- 5%: needed to make more changes than ReadyReturn website allowed;
- 4%: found it too confusing;
- 3%: preferred using a non-governmental e-file company; and
- 20% wrote in other reasons such as no computer or Internet access, or not sure how to change income/deductions.

From these responses, it is clear that some people are more comfortable with other forms of assistance, such as tax preparer services and non-governmental e-file companies, than with a prefilled return, while others either lack computers or Internet access or have concerns over the security of web-based transactions.

The report by 22% of the respondents that they had already filed a return prior to receiving their ReadyReturns is consistent with administrative statistics that indicate that 20% of invited taxpayers in the subsequent processing year had already filed. Under the current version of the program, all eligible taxpayers can ask to participate and they have access to a

ReadyReturn as soon as relevant third-party information has become available to the CFTB. However, even under this approach, some taxpayers (particularly those with refunds) may be unwilling to delay filing until the CFTB receives this information.

Even some of the non-participants found the ReadyReturns that they had received with their invitations useful. Although 55% of respondents reported that they did not use them at all,

- 20% used the prefilled returns to double-check their figures;
- 10% gave them to their preparer or accountant;
- 5% used them to complete the return themselves; and
- 10% used them for other purposes.

## 4 Impact of the pilot program

To gauge the impact of the pilot program on taxpayers' behaviour, I have performed some preliminary statistical comparisons of administrative and survey results for taxpayers who were invited to participate in the program with comparable statistics for taxpayers in the control group. For the administrative statistics (CFTB, 2006b), which cover most or all of the relevant populations, such differences should provide a reasonable indication of the program's impact, since taxpayers were randomly allocated to the invited and control groups. In the case of the survey statistics, the results are more speculative, owing to the potential for non-response bias discussed above in section 3.1.

These estimates, which are based on differences in behaviour between the invited taxpayers and the control group, provide what is known in the statistical literature as a measure of the "average treatment effect" among the population of taxpayers eligible for the pilot program. In particular, they provide a measure of the average impact of the program on those taxpayers whom the tax agency would like to have participate (or, in statistical jargon, those the CFTB has an "intention to treat"). Such estimates of program impact take into account the fact that only a fraction of the taxpayers that the CFTB has an intention to treat actually take part in the program.

It should be noted that this analysis is applicable to the program eligibility rules and procedures in place during the pilot program. Appropriate caution should be taken when attempting to extrapolate from these results to the current full-fledged program, which relies on broader eligibility rules and an opt-in participation process or to some other notional or actual prefilled tax return program.

My analysis focuses on the following five indicators of taxpayer behaviour:

- 1 electronic filing;
- 2 direct deposit of refunds;
- 3 fall-out (i.e., for manual processing);
- 4 correction notices; and
- 5 time to complete and file a return.

The first four items are indicators of processing costs. For instance, paper returns are approximately three times as costly to process as electronic returns. In addition, refunds processed by mail are four to five times as costly as those processed through direct deposit (McDaniel, 2005). The fall-out rate represents the percentage of returns that “fall out” for manual processing. One of the reasons that returns fall out is a discrepancy between the information available to the CFTB and the information reported on the return. Since ReadyReturns rely on information available to the CFTB, one would expect their usage would lead to a reduced fall-out rate. Correction notices are sent to taxpayers when the CFTB makes changes to a return during processing. Since manual checking and making changes to returns is resource-intensive, the fall-out rate and correction-notice rates have a positive association with processing costs. The last item is an indicator of burden of compliance that taxpayers bear. To summarize, then, my analysis based on these indicators should provide a useful sense of the impact of the pilot program on some important sources of administrative processing and taxpayer compliance costs.

Based on the results of this analysis (table 3.3), it appears that the tax year 2005 ReadyReturn pilot program had a positive impact on the rate of electronic filing but essentially no impact on use of direct deposit. Even with a program take-up rate of only 20.8%, electronic filing among eligible filers is estimated to have improved by about 2 percentage points as a result of the program.

**Table 3.3: Estimated average effect of program on eligible population, tax year, 2005\***

Indicator	Invitees	Control	Average treatment effect (Invitees – Control) (percentage points)
Electronic filing rate	43.0%	41.0%	2.0**
Direct deposit rate	25.7%	26.0%	–0.3
Fall-out rate	8.8%	14.0%	–5.2**
Correction-notice rate	7.3%	4.0%	3.3**
Time to complete and file a return	38 minutes	45 minutes	–7 minutes***

Notes: \* Result for time to complete and file a return is for tax year 2004. \*\* Statistically significant difference at 5% level. \*\*\* The necessary information is not available to assess statistical significance.

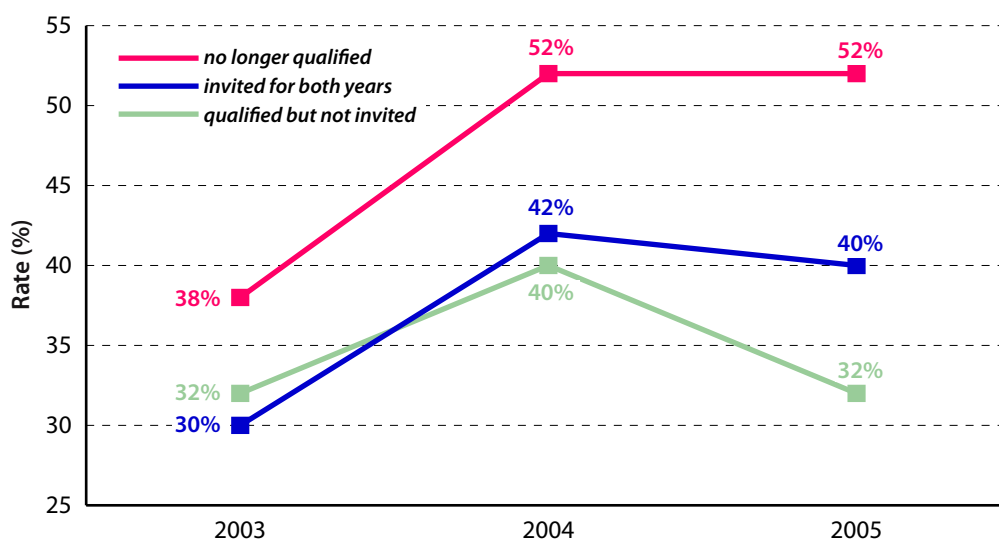
Source: Author’s calculations based on CFTB, 2006b.

The fall-out rate among eligible filers is estimated to have decreased substantially (by 5.2 percentage points) as a result of the program, presumably reflecting the fact that most ReadyReturns were filed as is and, as a result, matched the information on file at the CFTB. However, the correction-notice rate is actually estimated to have increased by over 3 percentage points as a result of the program. In part, this may reflect the fact that some participants had already filed a return prior to submitting their ReadyReturns. Administrative statistics indicate that 1.5% of participants submitted a duplicate return, compared to only 0.5% for the control group. Presumably, a duplicate return would typically result in some form of correction notice.

For taxpayers, the ReadyReturn pilot program is estimated to have reduced the average filing and preparation time by 7 minutes. In contrast to the other indicators, which are based on administrative statistics for the relevant populations, the measure of the time burden for taxpayers is based on survey responses. Therefore, one should keep in mind the potential for non-response bias when evaluating this result.

The CFTB report on the ReadyReturn program for processing year 2006 (CFTB, 2006b) also provides some evidence on the persistence in electronic filing behaviour. Among taxpayers invited to participate in the pilot for tax year 2004 were 2,782 taxpayers who happened to get invited to participate again for tax year 2005. Another 2,770 of the prior-year participants met the criteria to participate in tax year 2005 but were not invited. Finally, 5,971 prior-year participants did not meet the participation criteria for tax year 2005. Each of these groups had shown a substantial year-over-year increase in electronic filing behaviour between tax year 2003 and the subsequent tax year when they participated in the ReadyReturn pilot (figure 3.1). Furthermore,

**Figure 3.1: Trends in electronic filing rates, ReadyReturn participants, 2003–2005**



Source: CFTB, 2006b: 27.



the group of taxpayers who no longer qualified as well as the group who were invited to participate for a second time largely maintained their increased electronic filing participation rate in tax year 2005. However, the group of taxpayers who were qualified to participate in tax year 2005 but were not invited reverted back to their lower tax year 2003 rate of electronic filing participation.

## 5 Program Costs and Benefits

The CFTB (2007b: 6) reports that the cost of administering the ReadyReturn pilot amounted to \$222,000 for the first year and \$161,000 for the second. A breakdown of the projected administrative costs and benefits for the first three years of the full-fledged program are provided below in table 3.4. As is evident, the program is anticipated to have a positive net administrative cost in each of these years. However, the CFTB envisions that net costs should further decrease as the number of ReadyReturn users grows over time and the rate of electronic filing increases. The projected benefits include administrative savings resulting from increased electronic filing and reduced manual processing and correction of returns.

These figures do not take into account the benefits to participants in terms of reduced compliance burdens. Even at the current level of participation, these benefits almost certainly outweigh the net administrative cost. According to table 3.4, the net administrative cost of the ReadyReturn program for tax year 2008 is estimated at \$143,000. In this tax year, 61,753 ReadyReturns were filed. Therefore, if the average participant experienced a reduction in the burden of complying of as little as \$2.40, the aggregate taxpayer savings would have exceeded the estimated net administrative cost. As discussed in section 1, Goolsbee (2006) estimates that prefilled returns at the federal level would save participants \$85 in compliance costs per year on average. Although no comparable estimate for the per-capita compliance cost savings associated with a state prefilled return program is available, it would seem likely that such a program would save participants who previously completed and filed their own returns an hour or more spent in preparing and filing returns, while also lessening the reliance of other participants on paid preparation services. Overall, for every dollar in net administrative costs from running the ReadyReturn program there is likely to be many dollars in savings in time and tax-preparation expenses for participants.

The ReadyReturn program is not expected to have much impact on overall tax compliance levels. The taxpayers who qualify for the program tend to have very simple returns and their income is typically subject to substantial third-party information reporting. Therefore the scope for non-compliance among such taxpayers tends to be limited. Further, the CFTB (2006a: 30) reports that the total amount of adjusted gross income reported



**Table 3.4: Estimated ReadyReturn costs and benefits, 2007–2009**

Category	2007 tax year	2008 tax year	2009 tax year
<b>Costs</b>			
One-time IT costs: online application	\$171,000		
One-time IT costs: IVR* application	\$70,000		
Annual IT costs: online application	\$108,000	\$122,000	\$126,000
Annual IT costs: IVR application		\$19,000	\$19,000
Yearly staff costs: taxpayer calls	\$72,000	\$162,000	\$192,000
Yearly mailing costs	\$21,000	\$63,000	\$112,000
<b>Subtotal: Costs</b>	<b>\$442,000</b>	<b>\$366,000</b>	<b>\$449,000</b>
<b>Benefits</b>			
Benefits from on-line filing	\$92,000	\$212,000	\$282,000
Benefits from paper filing	\$4,000	\$11,000	\$19,000
<b>Subtotal: Benefits</b>	<b>\$96,000</b>	<b>\$223,000</b>	<b>\$301,000</b>
<b>Net Costs</b>	<b>\$346,000</b>	<b>\$143,000</b>	<b>\$148,000</b>

Note \*: IVR stands for Interactive Voice Response, an automated phone application that accepts a combination of voice and touch-tone keypad input.

Source: CFTB, 2007b: 7.

to California by ReadyReturn participants during the 2005 processing year was within 99.9% of the adjusted gross income they reported on their federal income tax returns. In principle, the participants also could have understated their federal adjusted gross income but it is comforting that the two reports are so similar. Since eligibility in the ReadyReturn program is predicated on a prior-year resident tax return, it is not expected to have any direct impact on the behaviour of non-filers. However, to the extent that the program ultimately reduces the burden of tax reporting and filing, it may play some role in bringing non-filers into the system.

## 6 Political Issues

The CFTB faced a divided public in implementing the ReadyReturn program. Proponents viewed it as means of helping to achieve the tax administration's duty to reduce taxpayer burden and efficiently process returns. Opponents, on the other hand, viewed it as an unwelcome government intrusion into the tax preparation business. An extended battle was waged in the California legislature over the future of the program and two bills attempting to make the ReadyReturn program permanent failed to make it through the legislature. Ultimately, the CFTB found a way to implement the program without explicit

legislative consent. After securing a legal opinion that the program fell within the Board's authority to determine the method and manner of tax filing in the state, the Board voted unanimously on December 4, 2006 to institute a full-fledged version of the ReadyReturn program and to fund it entirely from the existing CFTB budget.

The CFTB (2007b: 5) views the program as part of its obligation to make the filing process as simple as possible. In particular, it states that:

- taxpayers should have free assistance in completing the simplest of returns;
- the service can benefit low- and middle-income taxpayers who may not have access to computers or to tax preparers;
- taxpayers should know what information we have about them; and
- ReadyReturn introduces taxpayers to e-file and our related on-line services.

## **7 Lessons Learned**

- 1 Pre-completed tax return programs can be controversial, owing to differing views of the proper role of government in tax preparation.
- 2 At least as the California program is run, one should not expect a significant change in tax compliance behaviour; rather, the likely benefits are reduced taxpayer burden among taxpayers with simple circumstances and certain improvements in processing efficiency.
- 3 With the ReadyReturn program and other similar programs, it is reasonable to expect non-trivial net administrative costs at least for the first several years of implementation; however, such costs are likely to be more than offset by the benefits to participants in the form of a reduced compliance burden.
- 4 With limited funding for advertising, one can expect only modest levels of program participation in the early years of the program.
- 5 At least in the United States, program participation is hampered by the lag in receiving wage information from employers. In California, only 40% of fourth quarter wage data is available by February 15, which is the early refund peak; by mid-March, 95% of the data is available (CFTB, 2008b: 2).
- 6 At least for taxpayers with very simple tax circumstances, a very high percentage of pre-completed returns are filed as is without any changes.
- 7 The population of taxpayers with very simple tax circumstances includes low-, middle-, and high-income earners.

- 8 As with ordinary electronic filing programs, taxpayers need assurance that their private information is secure.
- 9 It is important to have a sound plan for collecting and analyzing administrative and survey data to evaluate program performance and impacts.

## 8 Concluding Remarks

Overall, it is unclear at this point whether ReadyReturn will serve as a niche program for a rather small and select group of taxpayers with extremely simple tax circumstances or as a broader program that serves a reasonably substantial segment of the overall taxpayer population. Even in the latter case, however, the aggregate reduction in compliance burden of taxpayers is expected to be fairly modest, because the program is not feasible for taxpayers with relatively complex tax circumstances, and such taxpayers experience the lion's share of the overall compliance burden. To illustrate this point, it is worth while to revisit Goolsbee's proposal for a federal prefilled return program that was previously discussed in section 1. Under this proposal, up to 52 million individual income tax filers in the United States (40% of the overall filing population in tax year 2003) would be eligible to participate in a federal filing program similar in design to the California ReadyReturn program. By Goolsbee's estimate, the average compliance burden among participants would be reduced by as much as \$85. Under the optimistic assumption that all eligible filers would participate in the program, this would translate into an aggregate burden reduction of \$4.4 billion based on statistics from tax year 2003. Applying Slemrod's (2005) estimate that the average compliance burden within the taxpayer population amounts to 10.5% of income tax receipts, the overall US federal individual income tax compliance burden in that tax year was approximately \$83 billion.<sup>14</sup> Therefore, even with 100% participation in a proposed prefilled return program that would be extended to 40% of the general filing population, the overall compliance burden could be expected to decrease by a maximum of 5.3% (\$4.4 billion divided by \$83 billion). So, clearly a prefilled return program falls well short of being a panacea for an enormously complex and burdensome income tax regime. Nevertheless, it does have the potential to provide a meaningful burden reduction at a very modest administrative cost to a substantial number of taxpayers, many of whom have low to moderate levels of income.

<sup>14</sup> This figure is based on an estimated \$794 billion in federal individual income tax receipts for fiscal year 2003 (Council of Economic Advisors, 2003: 33).

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Chapter 4

# Québec

by François Vaillancourt<sup>1</sup>

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<sup>1</sup> We thank Niels Veldhuis for his comments on a first version of this paper.

In December 2007, Revenu Québec announced that a target group of 100,000 tax filers would receive a prefilled 2007 personal income tax (PIT) form; 80% of these tax filers were aged 65 and over. This represents one third of filers in this age group who had prepared their Québec tax return using a paper form in previous years (Revenu Québec, 2007). This initiative was presented as a partial response to the request by older Québec residents for simplified relations with the government.<sup>2</sup>

The minister for Revenu Québec indicated then that this was to be the first step in a process with three additional steps (Revenu Québec, 2007).

- 1 In 2009 (for the 2008 fiscal year), 300,000 individuals filing a paper form should receive a prefilled form.
- 2 In 2010 (for the 2009 fiscal year), this would be offered electronically to 1,000,000 tax filers with a stable family and fiscal situation;
- 3 In 2011 (for the 2010 fiscal year), almost all Québec tax filers would receive a prefilled form.

The minister also indicated that he hoped to involve the federal government so that sometime between 2010 and 2020, both returns could be produced jointly; it is not clear if this is for prefilled returns or not.

Since the use of prefilled tax returns is promoted by the OECD as an improvement in tax services; and policy initiatives by provinces such as Québec can be and are sometimes followed by similar initiatives at the federal level (Vaillancourt, 2007); and there appears to have been only one other case (California) of a sub-national tax administration introducing a similar policy, it seems appropriate to examine it in some detail. We do this using information from both minutes of the steering committee and a summary report (Revenu Québec, 2008)—*Le Bilan*—obtained by two requests under the provincial freedom of information act.

Tax filers with certain characteristics were selected for the opportunity to use a prefilled return. The use of such characteristics makes it unlikely that one can generalize the results to all tax filers.<sup>3</sup> Those selected:

- ♦ used a paper form;
- ♦ had no children for tax purposes;

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2 At the press conference, the minister responsible for older people (ainés) was present.

3 Information on the selection criteria is drawn from Annex 2, *Le Bilan* (Revenu Québec, 2008).

- had no spouse or, if they had a spouse, the spouse was similar to them (again for tax purposes!);
- were members of a couple that did not transfer income between themselves;
- did not receive in 2006 an advance payment of the income tax credit associated with an older person remaining at home;
- had income in their 2006 return which Revenu Québec was certain it could include it in the prefilled return (OAS/GIS,<sup>4</sup> CPP/QPP, welfare);
- would not use deductions or credits for financial expenses, residency in a remote area, disability, caregivers related to recipients of care (*aidant naturel*), contribution to a political party, volunteer respite services (*relève bénévole*), tuition fees transferred from a child.

Examining only data for the 2005 taxation year yielded 244,146 possible participants, with 115,975 aged 65 and over and 128,351 under 65 years of age. Adding the requirement of a stable income profile during 2004, 2005, and 2006 reduced that total to 146,079 with 92,259 tax filers aged 65 and over and 53,820 under 65 years of age. Then, those who had in the past requested an anticipated refund in February or early March were excluded as they were less likely to want to wait until mid-March when they would receive the prefilled return. This reduced the numbers to 79,751 over 65 and 48,657 under 65 years of age. The group of those under 65 years of age was reduced again by excluding tax filers with spouses and those with interest or pension income. This last exclusion<sup>5</sup> is justified in Revenu Québec's documents on the basis that this makes it more likely that any new information will reduce rather than increase the amount of taxes to be paid. From the remaining 42,610 under 65 years of age, 20,249 were randomly selected to add up to 100,000 participants eligible *a priori*.

### Outline of the program

For the 2008 experiment, the initial steps were as follows:

#### 1 Preselected by Revenu Québec?

No exit process ➡

Yes next step ↓

<sup>4</sup> In practice, there was a delay in the availability of GIS information.

<sup>5</sup> This is not noted in Annex 2 (Revenu Québec, 2008) but was raised in other documents.

- 2 January 11, 2008: Pre-selected tax filers sent a letter with their regular tax return advising them of their pre-selection and of a forthcoming letter.
- 3 February 5, 2008: Pre-selected tax filers sent that letter with a pamphlet presenting the program and asking if they wished to receive the prefilled form.  
    **No** Phone a free telephone number to decline ➡  
    **Yes** Do nothing, form will arrive in March ↓
- 3 Reviewed by Revenu Québec
  - If changes detected (type of income ...) or tax filer deceased, offer is withdrawn and exclusion letter sent. ➡
- 4 March 18 and 20, 2008: Prefilled form was sent (March 10 and 13 planned).

Once the tax filer had received the prefilled form, the following steps were to be followed.

- 1 Answer the following three questions with “yes” (if one answer is no, the tax filer must use the regular form):
  - same marital status in 2007 as in 2006;
  - only pension, welfare, and interest income;
  - no use of seven specific deductions or credits.
- 2 Check the prefilled amounts. If they are incorrect, you cannot correct them and must use the regular form.
- 3 Add information on the back of the prefilled form on specific incomes, medical expenses, charitable contributions, expenses on home support services, or property taxes. If such information was added, Revenu Québec recalculated the income tax or refund owed, and sent a notice of assessment<sup>6</sup> with the new amount. It was not possible using the prefilled form to calculate the amount of taxes owed or the refund to be received when new information was added.
- 4 Ask (or not) for the Québec sales tax (QST) credit.

### **Communicating the program**

The launch of this program was accompanied by a series of communication activities such as advertisements in media targeting older individuals. The theme of helping older tax filers came through as the press review shows that

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6 All tax filers receive such a notice.



70% of media comments noted this.<sup>7</sup> Interestingly enough, the government notes that a website was prepared as part of these communication activities yet they targeted the sociodemographic group most likely not to use the Internet.<sup>8</sup> Meetings were also held with private providers of tax-preparation software and tax-preparing services. Both groups expressed concerns about the impact of this initiative on their markets but the first group also saw an opportunity of making their product more attractive if it could be meshed with the government's electronically provided information.

Of the 100,000 selected tax filers, 92,982 received a prefilled tax return; the remaining 7,018 did not, either because they declined to participate or because their personal situation had changed (bankruptcy, change in family situation, death). Of the 92,982 recipients of a prefilled tax return, 30,938 made use of it for a take-up rate of 33.3% of recipients and 30.9% of the targeted population. This is less than the 50% expected take-up rate stated in late 2007; no discussion of this discrepancy appears in *Le Bilan*.

### Costs

The direct costs of the project were \$1,965,780. Most of these are internal costs of \$1,629,000; postage and printing were \$248,000 and communication activities, \$88,780. Costs were also incurred in the *direction générale des particuliers*: \$62,140 and the *direction principale du traitement massif*: \$32,000. Thus the total costs were \$2,059,920 (Revenu Québec, 2008: 4). The discussion in *Le Bilan* of these costs shows that temporary measures were used in the tax-return processing chain; this means that, should the program be generalized, that permanent changes would need to be made to the tax-return processing chain and that the temporary changes would likely be of little use, except perhaps as a learning experiment.

### Characteristics of users and non-users

The only sociodemographic information we have on users and non-users of prefilled returns is their age and marital status. Table 4.1 shows that users of prefilled forms tend to be younger within the target group that is mainly 65 and older than those who chose not to do so; this may indicate some conservatism in choices associated with age. There is little difference in the percentages by marital status with 84.6% of users of the prefilled form having a spouse while this percentage is 85.7% for users of the regular form.

As of June 1, 2009, 88,009 prefilled or regular tax returns out of the 92,982 targeted individuals had been received. Table 4.2 shows that there were important differences between the expected tax outcomes and those

<sup>7</sup> Revenu Québec, 2008: 17–20, Annex 3; our calculations (29/42).

<sup>8</sup> Internet use in 2007 was above 80% for the 25–54 age groups: it was 45% for the 65–74 age group and 21% for those aged 75 and above (Veenhof and Timusk, 2009).

**Table 4.1: Distribution by age of users (%) of prefilled and regular tax forms from the prefilled sample, Québec, 2007 tax year**

	Prefilled return users (%)	Regular form users (%)
Ages 64 and below	23.6	17.9
Ages 65–69	15.4	14.7
Ages 70 and above	61.0	67.4

Source: Revenu Québec, 2008: 26.

**Table 4.2: Predicted tax outcome, prefilled and regular tax forms, prefilled sample, Québec, 2007 tax year.**

Tax assessment outcome	Predicted prefilled— all returns	Predicted prefilled— users	Actual prefilled— users
Refund (%)	4.7	2.6	16.8
Tax due (%)	40.6	34.3	30.9
Zero (%)	54.7	63.1	52.3
Number	88,089	29,923	29,923

Source: Revenu Québec, 2008: 5–6, tables 1 and 2, columns 1 and 3; Revenu Québec, 2008: 25, annex 4, table 7, column 2; percentages, our calculations

realized. For example, it was expected, based on information available to Revenu Québec, that only 4.7% of the prefilled sample would be entitled to an income tax refund; this percentage was based on 100% use of prefilled returns. It was revised downwards to 2.6% when the actual use of prefilled returns was known. But once income tax liability was established, it was 16.8% of users of prefilled returns that were entitled to a refund. So depending what base line one uses, this percentage was underestimated by a factor of four (16.8/4.7) or seven (16.8/2.6). On the other hand, the percentage of individuals not eligible for a refund was overestimated. That said, 81% of users of prefilled returns had a match between their expected tax outcome and their realized tax outcome. This percentage of matches was 62.4% for potential prefillers who used the standard form.<sup>9</sup>

These differences are explained by differences between the information available to Revenu Québec and that used by tax filers. In 60.2% of the cases, they added no information to the back of their form; 22.3% added one item; 8.4% added two; 4.3%, three; 2.7%, four; and 2%, five or more (Revenu Québec, 2008: 26, table 9, Annex 4). This excludes the QST credit, which was claimed by 80.8% of prefillers but has no impact on the personal income tax owed.

<sup>9</sup> Revenu Québec, 2008: 26, table 7, Annex 4; percentages, our calculations (sum of diagonal elements).

**Table 4.3: Claims of allowed add-ons, by percentage of those using prefilled and regular tax forms, prefilled sample, Québec, 2007 tax year**

Item used in PIT calculations	Prefilled form users (%)	Regular form users (%)
Pension income	9.7	21.3
Interest income	14.4	25.4
Medical expenses	10.8	17.6
Charitable contributions	8.0	6.5
Income tax withdrawn at source	2.6	10.1
Older person home-stay expenses	2.1	3.7
Property tax credit	26.0	44.0

Source: Revenu Québec, 2008: 26, Annex 4, table 8.

It is interesting to examine what was claimed by users of the prefilled form and to compare it to what was claimed by users of the regular form (table 4.3). We find that, in general, possible users of prefilled forms who choose not to use them were more likely to have additional types of income than those who did use the prefilled form. They also were more likely to have income tax withdrawn at source; one wonders why Revenu Québec prepared a prefilled return without using information on tax withdrawn at source. The information on total income tax withdrawn at source is reported by the end of February of a given calendar year for the previous year. Perhaps it is not compiled quickly enough for inclusion in the prefilled forms.

In addition to the lines at the back of the prefilled form, the assessment process identified, for users of the prefilled forms, line items that should have been used and were not. A total of 32 such items were identified for 5.5% of the prefilled users. Of these 5.5% of users, 79.4% had to make a contribution to the health services fund<sup>10</sup> and 17.5% had paid provisional income tax on a quarterly basis; why this last item of information available to Revenu Québec was not included in the prefilled form is not known. That said, we note that 94.5% of users of the prefilled returns did not need to enter any additional information; this indicates good self-selection by such users amongst those targeted by Revenu Québec. What is perhaps more intriguing is that 85.8% of the recipients of a prefilled return who chose to use the standard tax form need not have done so; the prefilled return was adequate (Revenu Québec, 2008: 27–30, tables 10, 11, Annex 4).

It is not surprising that the average effective refund is lower, and the average tax due higher (table 4.4), than the prefilled amounts for these two items since, in most cases, changes in the prefilled form were the result of adding information on sources of income not included.

<sup>10</sup> Fonds des services de santé du Québec. This is a tax on non-wage income.

**Table 4.4: Predicted and effective tax outcome (average amounts, \$), users of prefilled tax forms, prefilled sample, Québec, 2007 tax year**

Tax assessment outcome	Expected (stated in prefilled form)	Effective (after assessment by Revenu Québec)
Refund (\$)	-825	-224
Tax due (\$)	115	234
Number	88,089	29,923

Source: Revenu Québec, 2008: 5–6, tables 1, 2.

### Evaluation from those invited to use the prefilled return

Individuals who received a prefilled return also received a short questionnaire with which to evaluate it. The questionnaire asked:

- 1 Did you use or not the pre-completed return and, if yes, who completed it, you or someone else?
- 2 If no, was it because of:
  - family situation/tax profile change?
  - wanted to change/add amounts?
  - did not know if would receive all the credits entitled to?
  - could not obtain the final result immediately?
  - prefer to use same type of return as last year?
  - use computer software to complete my return?
  - other.
- 3 What was the understandability of completed tax return?
- 4 How clear was the information in the brochure that accompanied the prefilled tax return?
- 5 Did the use of the prefilled return facilitate your tax filing activities?
- 6 Should the prefilled form be offered or not next year?

A total of 10,661 answers were received (as of May 31, 2008). Of those, 9,923 contained usable answers and were analyzed; 738 were set aside.<sup>11</sup> Of the 9,923 answers, 8,615 were from users of the prefilled tax return and 1308 from non-users. Thus the answers from users reported in table 4.5 can be seen as fairly representative of the overall opinion of this group while, when analyzing those from non-users, one should proceed with caution given the small sample size. For those users of the prefilled return who provided

<sup>11</sup> They contained “des incohérences majeures” (Revenu Québec, 2008: 7).

**Table 4.5: Opinions of users of prefilled tax forms, written survey, prefilled sample, Québec, 2007 tax year**

	Percentage of respondents who said "yes" to questions	
	Users	Non-users
The prefilled return was easy to understand	98.9%	70.9%
The information in the explanatory document was clear	98.5%	73.2%
The use of the prefilled return facilitated filing tax return	98.3%	NA
Prefilled returns should be offered next year	98.4%	35.4%

Source: Revenu Québec, 2008: 35, table 6.

a usable answer to question one on tax preparation, 53.4% completed the form themselves while 44.4% had someone else prepare it for them (Revenu Québec, 2008: 34, table 3, Annex 5).

Those who chose to not use the prefilled returns provided reasons either by telephone when they declined or when they sent in answers to the survey. A total of 13,748 phone calls were received from selected possible participants. Of those, 6,143 phone calls indicated a refusal to use the prefilled return. The main reasons given were (Revenu Québec, 2008: 39, table 2, Annex 6):

- offer received too late: 52.2%;
- prefer the usual form: 46.1%;
- helped by someone else: 4.1%;
- amount owed/due not known immediately: 4.0%;
- did not trust this new form/approach: 3.5%;
- other answers (10 possibilities): 15.2%.

The sum of the percentages is 125.1% as more than one reason could be given. Other telephone calls raised questions as to the invitation letter, the prefilled form, and the associated brochure or asked for guidance in using the prefilled form. In this case, questions were asked mainly as to what amounts should be written in. Interestingly, 545 calls were received by individuals not selected for the program but who were interested by this possibility and wanted to know how to obtain such a form (Revenu Québec, 2008: 39, table 1, Annex 6).

In the answers to the written survey, the top five answers for not participating were (Revenu Québec, 2008: 34, table 4, Annex 5):

- prefer using the same form as last year: 50.5%;
- filled in reasons (not stated): 48.5%;
- amount owed/due not known immediately: 35.3%;
- had to modify amounts or write some in: 28.3%;
- not sure they would benefit from all appropriate credits using that form: 25.2%.

Others (3) accounted for 10.9% of the multiple answers that sum to 198.7%.

## Result of experiment

Following this experiment, the decision was taken to keep offering the prefilled form to those who had received it for 2007 and to abandon the plans to expand the use of prefilled forms to other tax filers.

## Conclusion

The restrictive criteria enumerated above are such that one cannot generalize the results discussed above to all tax filers in Québec. That said, it seems feasible to use prefilled personal income tax forms in a subnational jurisdiction. Whether the reduction in compliance costs would justify the increased administration costs and the possibly lower interest by individuals in their tax affairs associated with prefilled returns is not known. One possibility not explored is making accessible in electronic form for download the tax information available to a revenue authority so tax filers could use it in their own tax preparation programs. This would reduce compliance costs while maintaining the need for individuals to calculate their tax liabilities and thus to take an interest in their tax affairs. This can be seen as a decentralized version of prefilled tax returns.

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Chapter 5

# Spain

by José M. Durán-Cabré<sup>1</sup>

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<sup>1</sup> I thank Fernando Díaz Yubero, former director of the department of Organization, Planning, and Institutional Relations of the Agencia Estatal de la Administración Tributaria (AEAT), for his generous assistance in providing me with specific information relating to the prefilled tax return. I also thank Josep Costa, Chief Executive of the Catalan tax agency, for his useful comments. I am grateful for funding from the Spanish Ministry of Science and Technology (ECO2009-12928) and the government of Catalonia (2009SGR102).

## 1 Introduction

A traditional principle of taxation is simplicity, which means that taxes should be easy to understand, to comply with, to administer, and to control. Regulating, applying, collecting, and controlling taxes can be expensive; therefore, it is reasonable that scholars and practitioners have concentrated on this issue. In a first stage, the traditional concern was concentrated mainly on the administrative costs of taxes, that is, the public administration costs of running the tax system. However, there are also the tax compliance costs, that is, “the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. They are costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax” (Sandford, 1995: 1).

The main findings of the research on tax compliance costs (e.g. Sandford, 1995; Slemrod, 2005; Vaillancourt et al., 2008) are probably:

- tax compliance costs can be large, taking up substantial resources and therefore offering scope for substantial savings;
- tax compliance costs have undesirable distributional effects, falling with disproportionate severity on small firms and low-income individuals;
- tax compliance costs may generate particular resentment, adversely affecting voluntary compliance.

These results indicate the significance of tax compliance costs and explain the increasing interest in the subject both by the academic community and by governments. Indeed, in recent years reducing the administrative burden on business and citizens has become a priority item on the political agenda of many countries in the Organisation for Economic Co-operation and Development (OECD). Many governments have even set sizeable global targets for reducing the burden of compliance (OECD, 2008). Therefore, reducing tax compliance costs seems to be feasible and prefilled personal tax return systems is one of the means to achieve it.

In Spain, as in many other OECD countries, the system of personal income tax in place requires most taxpayers to file an annual tax return. Taxpayers report all their taxable income and calculate the corresponding tax liability. However, quite often the tax administration already has this information available. All income from employment, most income from capital and business, and certain capital gains are already taxed through withholding taxes and third parties like employers, banks, and other financial institutions must report this information to the tax administration before taxpayers file their annual tax returns. The Spanish tax agency, as common in other



OECD tax administrations, traditionally used the third-party reports to detect unreported income. However, as is taking place in other tax administrations, this traditional approach has changed and, since 1998, the Spanish tax agency has begun to use third-party reports to inform taxpayers. At the beginning, taxpayers only received tax data of their income subject to withholding tax in order to make filing the tax return simpler. However, since 2003 they have started to receive a prefilled tax return where possible.

The aim of this chapter is to analyze the Spanish experience with reducing tax compliance costs stemming from personal income tax and, more precisely, with introducing the prefilled tax return system. Nonetheless, this is done in a broader context as the prefilled system is in fact the natural consequence of an increasing use of new technologies. This was done first with the more traditional objective of detecting unreported income but later with the aim of more modern tax administrations, helping and making simpler tax compliance. Before analysing the administration of the personal income tax, I introduce very briefly the personal income tax in Spain.

## 2 Personal Income Tax in Spain

In Spain, income tax covers all sources of income obtained by natural persons who are normally resident on Spanish territory. Taxpayers must report all sources of income (from employment, from capital, and from business) and capital gains, as well as certain imputed income (mainly from urban real estate other than the habitual residence). In addition, the regulations fix certain deductions and tax credits, which vary from one taxpayer to another.

The tax has traditionally worked under a self-assessment system: taxpayers must fill in a tax return, reporting all their taxable income and calculating the tax liability. In practice, however, before submitting tax returns most revenue is already collected at source through a withholding tax, whose amount is credited against the tax liability of the return. Because of the withholding tax, not all taxpayers have to file a return; this is compulsory depending on the level and the sources of income. For instance, in 2009 taxpayers whose income come exclusively from employment activities and is less than €22,000 were not obliged to file a return.

Since 2007, an important feature of the tax system has been its duality. There are two tax bases, the general and the savings, which are taxed at different rates. Thus, while the general base is taxed according to a progressive schedule (with four brackets and marginal rates from 24% to 43%), the savings base is subject to a single tax rate (18% until 2009 and, since 2010, 19% on the first €6,000 and 21% on the rest). The general base mainly includes employment earnings, income from property rentals, and business income.

The savings base principally includes interests, dividends, and other capital income, as well as capital gains. Therefore, the current income tax is similar to Nordic dual tax, although rents and business income<sup>2</sup> in Spain are taxed within the general base.

### Compliance costs

Regarding compliance costs of the tax, there are two important issues to be considered.

#### *National tax*

The Spanish Income Tax is a national tax, collected and regulated by the State.<sup>3</sup> However, 50% (33% until 2008) of the revenue accrues to regions (autonomous communities), which also have the right to introduce certain legal changes. Indeed, they can change the regional tax rates of the general tax base and introduce new regional tax credits, although under certain conditions, and, since 2010, regulate the general allowance.<sup>4</sup> Therefore, the personal income tax plays an important role on the financing system of the autonomous communities. However, there is a single tax return and the tax is only administered by the national tax agency (in Spanish, *Agencia Estatal de la Administración Tributaria* or AEAT).

Taxpayers must assess two different tax liabilities, one for the state and one for the autonomous community, but both in the same tax return. However, this is automatically done by the AEAT computer program, as taxpayers must fill in their region of residence. In fact, after more than ten years of the tax's being decentralised, most taxpayers do not yet know that a substantial part of the total tax liability goes to the regional government (*Área de Sociología Tributaria*, 2008). Therefore, from the perspective of compliance costs, the decentralisation of the tax has little impact for taxpayers.

Regional tax administrations do not play any role in the administration of the tax, although they help with filling in the tax return. This is a

2 An important issue regarding compliance costs is the assessment of business income, as small business can use flat-rate schemes, but this goes beyond the purpose of this paper.

3 In Spain, there is a special financing system for the so-called *foral* regions, which collect, regulate and administer their own income tax. Therefore, there are four other income taxes in Spain: three in the Basque Country (one for each province) and one in Navarre. These are different income taxes and the residents of these provinces, which only account for about 6% of the Spanish population, pay the corresponding income tax instead of the national one. In this article, I do not consider these other income taxes, which furthermore are only administered by the provinces. The information provided by the Spanish Tax Administration ("*Agencia Estatal de la Administración Tributaria*") refers only to the "national" tax.

4 See Ruiz Almendral and Vaillancourt, 2006 or Durán-Cabré and Esteller-Moré, 2006 for further information.

voluntary service offered by all regional tax administrations to their citizens with the aim of collaborating with the national administration.<sup>5</sup> Regional governments are not compensated for the cost of the service but, as they receive an important percentage of income tax revenue, regions also benefit from better compliance.

### *Recent reforms*

The tax has been substantially reformed over the last years. In fact, there were three major reforms in the last ten years: in 1999, in 2003, and in 2007, that is, in each legislative period. It seems that each new government must apply its own income tax! Furthermore, between those years, other minor changes have usually been introduced, apart from giving more legal power to the regions.

Changing the regulations very often may be important from a compliance perspective, as they introduce greater compliance costs (at least in the short run) and changes are not always coherent among themselves. For instance, the 1999 reform substantially reduced the number of taxpayers (figure 5.1) by increasing the threshold, improving the assessment of the withholding tax for employment income, as well as reducing substantially the number of tax credits. However, due to the decentralisation of the tax, since 2002 autonomous communities have started introducing an increasing number of regional tax credits, which are not taken into account when calculating the withholding tax. (In 2009, there were 120 regional tax credits, that is, on average 8 tax credits per region.<sup>6</sup>) Therefore, taxpayers eligible for regional tax credits may submit a tax return without being required to do so by national norms in order to benefit from the tax credit. Or, they may amend the pre-filled tax return sent by the tax administration.

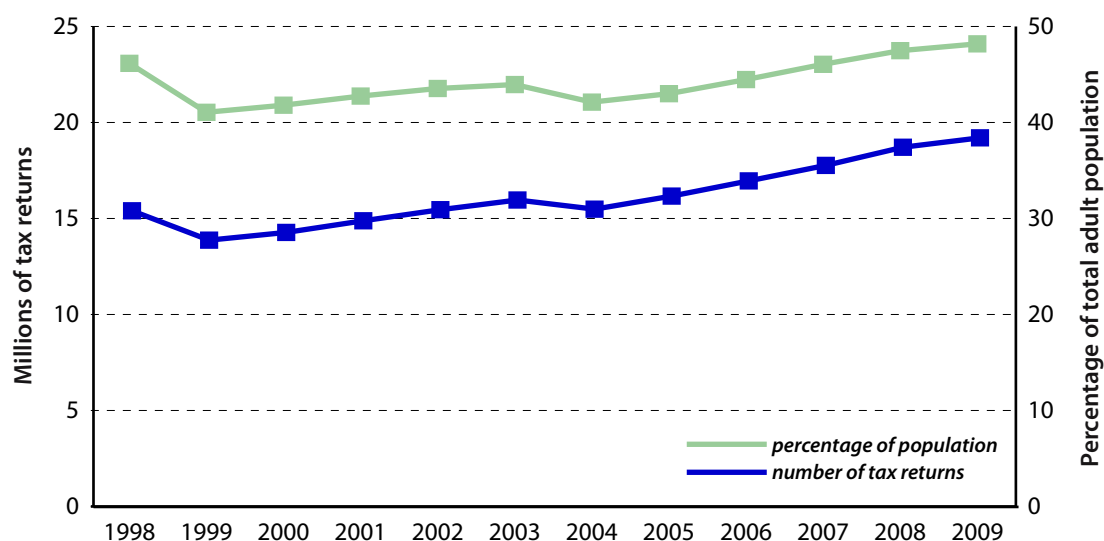
For the time being, only a small percentage of taxpayers can enjoy regional tax credits as they are very specifically tailored (Durán-Cabré, 2011). But the potential impact on the pre-filled tax-return system should be considered in the longer run.

In conclusion, for the purpose of the paper I consider the Spanish income tax as a single tax, since there is a single tax return and the tax is only administered by a national agency. Likewise, at least for the time being the impact of regional changes on the compliance costs of the tax, and more particularly on the pre-filled tax system, seem quite limited.

To conclude this brief explanation of the Spanish income tax, I show in figure 5.1 the total number of tax returns, which increases over the period from 1998 to 2009. The number of returns as a percentage of the adult

5 The service is completely free and is provided on request.

6 See Durán-Cabré (2011) for more detailed information about the regional tax credits.

**Figure 5.1: Tax returns, number and percentage of total adult population, 1998–2009**

Note: population over 18 years. Navarra and Basque Country are not included.

Source: AEAT, various years, *Memoria de la Agencia Tributaria*; Instituto Nacional de Estadística, various years; author's calculations.

population falls in 1999 due to the above mentioned tax reform but then increases steadily and, in 2009, reached 48% of the adult population. It is important to bear in mind that the Spanish economy has grown over the period, which causes an increase in the number of taxpayers as a percentage of the population.<sup>7</sup>

### 3 Administration of the personal income tax in Spain

The Spanish tax agency came into being in 1992 and is responsible for the effective application of the tax system. It is an entity under public law supervised by the Ministry of Economy and Finance. Therefore, it has its own legal personality, which confers a degree of autonomy in budgetary issues and management of human resources. The tax agency's primary objective is "to encourage the voluntary compliance of citizens with their tax obligations" (AEAT, 2007 *Annual Report*: 8). To achieve this, it performs two types of action: on the one hand, the provision of information and assistance services to taxpayers; on the other, the detection and correction of

<sup>7</sup> In fact, strictly speaking the number of tax returns is not the same in the Spanish income tax system as the number of taxpayers. The regulation foresees that natural persons in a family unit may opt for joint taxation. Therefore, tax returns can include more than one taxpayer. Nevertheless, it is common to use tax returns as equivalent to taxpayers, as I usually do in this paper.

tax defaults through control actions. In this paper, I consider only the first type, whose purpose is to minimize the indirect expenses associated with meeting tax obligations, that is, the compliance costs. More particularly, I concentrate on the personal income tax, probably the most important tax of the tax system because of its large effect on different grounds: efficiency, equity, simplicity, and revenue.

With the aim of assisting taxpayers in complying with the personal income tax, the Spanish tax administration provides different help services, which have changed over the last years. As a consequence of the technological developments (e.g., more powerful computer systems, the Internet, and other communication systems), the help services have been enhanced and widened: new services can be provided because of the new technological opportunities. To some extent, the introduction of the prefilled tax returns system can be considered as the natural result of an increasing use of the new technologies by the tax administration. A first step was designing a help computer program to file the income tax returns, as well as other tax returns. The following step was the sending of tax data to taxpayers by mail, the closest precedent of the prefilled system. In fact, once the prefilled system is generalized—it accounts for 72% of all tax returns, according to provisional data for 2009 (AEAT, various years)—tax data will still be available to taxpayers by mail when providing the prefilled tax return is not possible.

### 3.1 Help computer program—the PADRE program

The Personal Income Tax Return Help Program is designed to help taxpayers file their income tax returns. The PADRE<sup>8</sup> program was first introduced in the mid-eighties as a computer program for the tax administration offices. Taxpayers asking for the service had to go to the administration premises where the tax return was filed for them. Thus, the use of the program avoided arithmetical errors. In 1986,<sup>9</sup> when the service was first made available to the public outside the tax administration's premises, it was employed by 211,563 taxpayers and, in 1987, by 289,814 taxpayers. This accounted for 2.7% and 3.6% of all returns. In 1990, the computer program was made available on computer diskettes so taxpayers, tax practitioners, and collaborating entities (e.g., banks and savings banks), among others, could use the program in their own computers. The diskettes were sold along with official documents at very reasonable prices. The number of returns prepared with the PADRE program was 893,704 in 1990, that is, 8% of all filed returns. The use of the PADRE program had increased substantially.

8 PADRE is an acronym from the Spanish, Programa de Ayuda a la Declaración de Renta.

9 In Spain, the fiscal year coincides with the calendar year. The period for submitting tax returns goes from May to June of the following year. Therefore, returns submitted in 1986 are for the 1985 tax year and so on.

As the use of personal computers spread, the number of returns prepared using the PADRE program soared. In the mid-nineties, the returns made with the PADRE program already accounted for about 50% of all returns filed. In 2007 (for the 2006 income tax), almost 99% of all returns filed were prepared with the computer program (figure 5.2).<sup>10</sup> As we later will see, the use of the computer program allows offering other important services with the aim of reducing tax compliance costs. According to the tax agency, the PADRE program is simple, secure and trustworthy because it is written by the Spanish tax agency itself. Nowadays, the program can also be downloaded from the web site of the agency or on CD ROM.

### 3.2 Mailing tax data to taxpayers

Whenever a worker receives his salary, the employer must withhold a percentage of the earnings as an advance payment of the worker's income tax. The employer keeps the withheld money until it is paid to the tax administration, every month or every quarter depending on the size of the employer. Furthermore, once the year finishes, employers must file a report with detail information on all withholdings. In particular, for each worker they have to report: fiscal identification number;<sup>11</sup> name and surnames; gross earnings; and withheld amount.

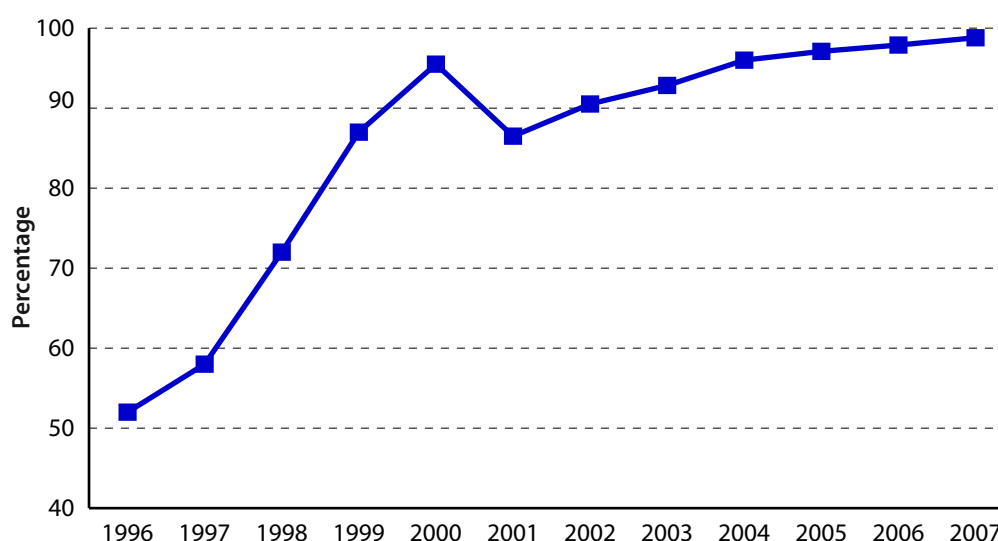
A similar process is followed for most sources of income: all income from employment, most income from capital and business, and certain capital gains. As a consequence, before taxpayers submit their income tax return, the administration already knows most of their earnings from the information provided by third parties. For that reason, in 1998 (for the 1997 income tax) the Spanish tax administration started to offer a new help service: the mailing of tax data to those taxpayers who asked for it. As one can see in figure 5.3, the service was used by 335,946 citizens (principal Y-axis), which accounted for only 2% of taxpayers (secondary Y-axis) (figure 5.3).<sup>12</sup> Five years later, in 2002, the total number of such documents sent was 2,601,416, that is, 17% of taxpayers.

According to the Spanish tax agency, the tax data service yielded excellent results in years past, "reaching all its taxpayer assistance goals and preventive objectives" (AEAT, *2003 Annual Report*: 65). For that reason, the service has been strengthened heavily through advertising campaigns in the media. Furthermore, it has been well received by citizens, who quickly realised that the information provided was very convenient, since on a sole

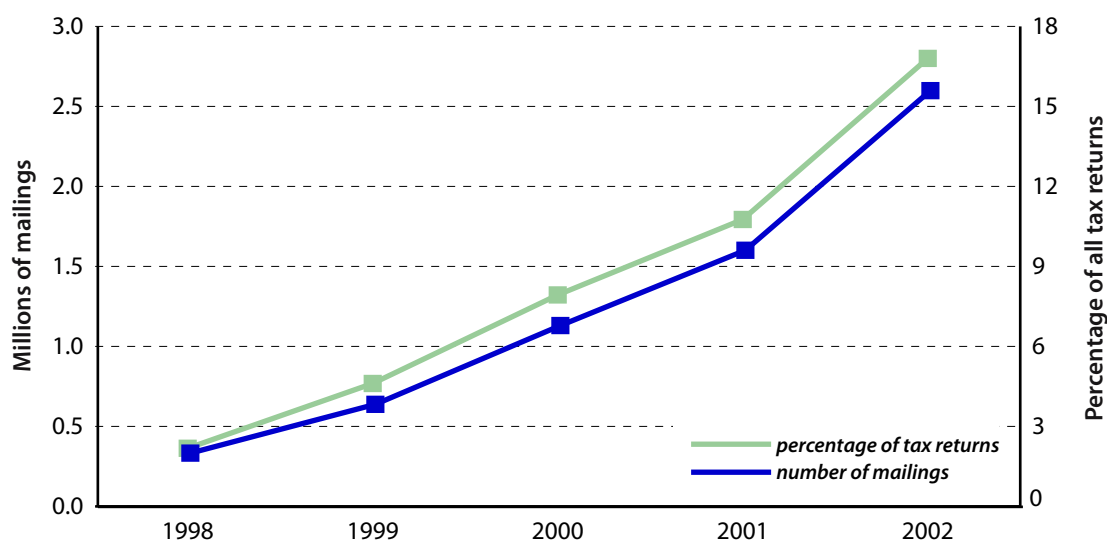
10 These numbers also include those returns prepared with privately provided tax preparation programs based on the PADRE software, which is freely offered by the AEAT to the private computing enterprises.

11 For natural persons, this is the same as number on the National Identity Card (DNI).

12 See footnote 7.

**Figure 5.2: The use of the PADRE program, percentage of all returns, 1996–2007**

Source: AEAT, various years, *Memoria de la Agencia Tributaria*.

**Figure 5.3: Tax data, number of mailings and percentage of tax returns, 1998–2002**

Source: AEAT, various years, *Memoria de la Agencia Tributaria*.

sheet of paper they could find almost all the relevant information for filing their tax return. In addition, the provided information was improved, including, for instance, income from property rentals subject to withholding, contributions to pension plans and funds, capital gains on the sales of investment funds, donations, and real estate information.

The tax data service is offered to all citizens but it is only provided on request. Taxpayers wishing to receive tax data have to ask for it, by telephone, Internet, or in person at the offices of the tax administration. The only information required to obtain the service is the fiscal identification number and



the gross tax liability of the previous year's tax return. In order to ensure confidentiality, the information is sent by mail to the fiscal address of taxpayers, regardless of who requests the service. Since 1999, the information can also be obtained from the website of the agency. At first, for security reasons, taxpayers needed a special electronic certificate but, later on, only the reference number given in the letter posted.

The remittance of tax data to taxpayers is a help service still provided by the Spanish tax agency but to some extent the service was integrated within a new service, the prefilled income tax return, which I turn to now.

### **3.3 Prefilled tax returns**

With the aim of making compliance easier, the AEAT first introduced in 2003 a pilot program for the 2002 tax year: the "draft tax return," in other words, the prefilled income tax return. The pilot program consisted of sending a letter to 1,500,000 taxpayers offering the opportunity of asking for the prefilled tax return. Therefore, participation in the pilot program was only by invitation, and basically among wage-earners and pensioners, whose all sources of income had been subject to a withholding tax. Selected taxpayers had to request the prefilled tax return, which otherwise was not sent. Along with the prefilled tax return, taxpayers received the tax data employed to fill in the return. This first year, the tax agency also made 23,737 phone calls to taxpayers who, in spite of being selected for the pilot program, had not requested the prefilled return but had asked for the appointment for help in preparing their tax returns.

The following year (2004, for the 2003 tax year) the program was extended to all taxpayers and was integrated with the sending of tax data. Taxpayers requested a single service, "tax data / pre-filled tax return," and the tax agency decides what it sends, depending on the sources of income taxpayers earn. Generally speaking, the tax administration mails the prefilled tax return when has enough information about the taxpayer's income to fill in the return. This is usually the case when the income is subject to withholding or additional information can be obtained from other sources. For instance, the imputed income from estates is available from the cadastral office. Otherwise, the tax administration does not have enough information to assess the tax base and, hence, cannot calculate the tax liability. If so, the tax agency sends the tax data in lieu of the prefilled tax return. Therefore, taxpayers always receive a useful answer to their request, either the prefilled return or the tax data.

To avoid legal problems, the Income Tax Act had to be modified and the prefilled tax return was introduced as another option offered to taxpayers to comply with their income tax obligations. Recall that self-assessment has been the traditional system for collecting the income tax in Spain. As a consequence, since 2004 taxpayers can ask to receive tax data or a prefilled



tax return. The tax agency sends a prefilled tax return when possible; otherwise, tax data is mailed. When taxpayers receive the prefilled tax return and they agree with the proposal, they can confirm it and it will be considered their final tax return from a legal perspective. Confirmation can be given by telephone, through the Internet, SMS, or coming in person to the tax administration offices or collaborating entities (mainly banks and savings banks<sup>13</sup>). If taxpayers do not agree with the prefilled return, they can either amend it or hand in a normal self-assessed tax return.<sup>14</sup>

When taxpayers belong to a family unit and, therefore, may opt for joint taxation, the prefilled tax return makes the most convenient option, whether a joint return or several individual returns are filed. Since 2005, taxpayers can also choose if they prefer receive the information in a co-official language other than Spanish.

Therefore, the prefilled tax return or tax data are options that have been offered to Spanish taxpayers since 2004. It is voluntary, so citizens have to ask to receive it. The request can be made in the tax return of the previous year or later by telephone, the Internet, or in person. Nonetheless, from a legal perspective, not receiving the prefilled tax return or tax data, even when it has been requested, does not exempt a taxpayer from the obligation of submitting a tax return.

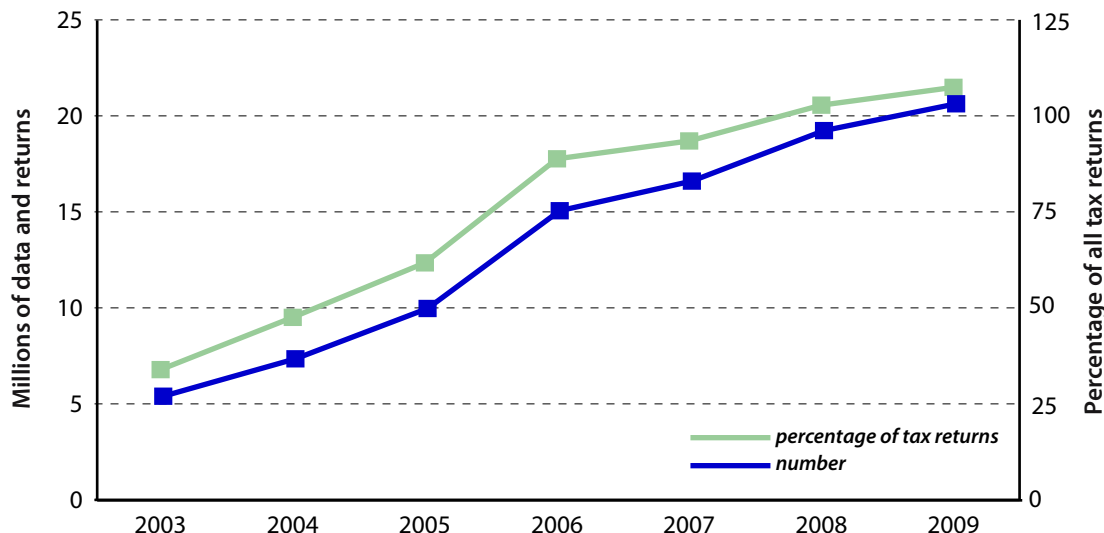
When the tax administration cannot provide a prefilled return, taxpayers receive their tax data, as happened before the new help service was introduced. However, another substantial improvement has been introduced since the 2003 tax year. Taxpayers, apart from receiving their data by mail, can view the data directly from the AEAT website or can even download it. Taxpayers receive a letter with a reference number that has to be introduced in the corresponding page of the AEAT website for access or to download the information. Therefore, having a special electronic certificate is no longer required, which makes it likely that taxpayers will download information much more often. Tax data downloaded is automatically incorporated into the PADRE program, which undoubtedly makes much easier and faster to file the income tax return.

In 2003, when the pilot program for prefilled returns was first introduced, the total number of requests for tax data and prefilled tax returns fulfilled was 5,422,459 (figure 5.4, principal Y-axis), which accounts for 34% of taxpayers (secondary Y-axis). In 2004, when the program was broadened, the number of sendings reached 7,370,757, that is, 48% of taxpayers. In the

13 Traditionally in Spain, banks, savings banks, and co-operative and rural banks are authorized credit institutions for tax issues. This means, for instance, that most tax returns (e.g., income tax, corporate tax, or VAT) can be handed in at the offices of these collaborating institutions.

14 Under the pilot program, amendment was not possible.

**Figure 5.4: Tax data and prefilled tax returns, number and percentage of all tax returns, 2003–2009**



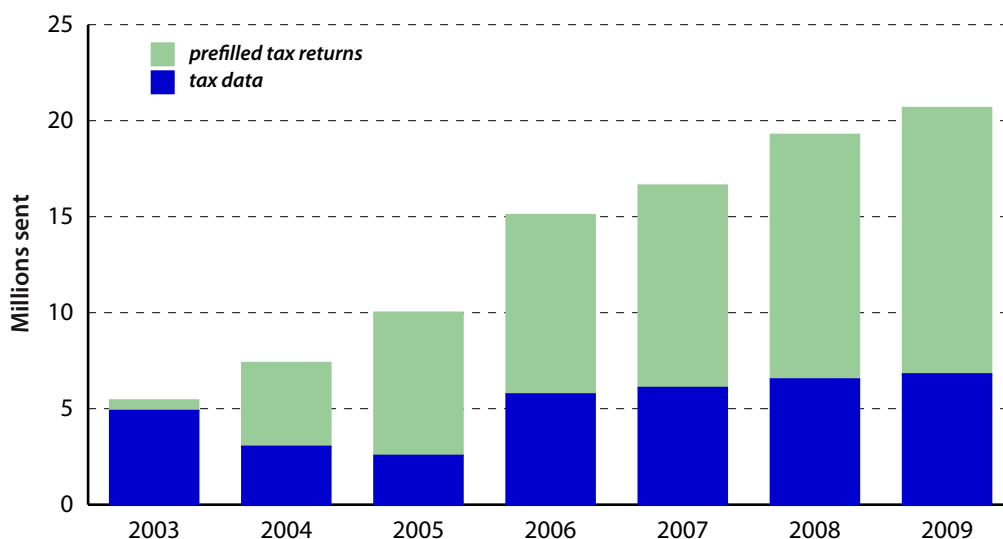
Source: AEAT, 2009; provisional data for 2008 and 2009.

following years, these numbers soared: in 2007, the last year for which definitive data are published, the tax agency sent the service required to 16,627,255 citizens, that is, 93% of taxpayers. The provisional information for 2008 and 2009 shows that the number of citizens requesting the service has increased again and is even greater than the total number of taxpayers. This is because the Spanish income tax allows natural persons in a family unit to opt for joint taxation. Therefore, taxpayers that have requested information separately may choose joint taxation in the end.

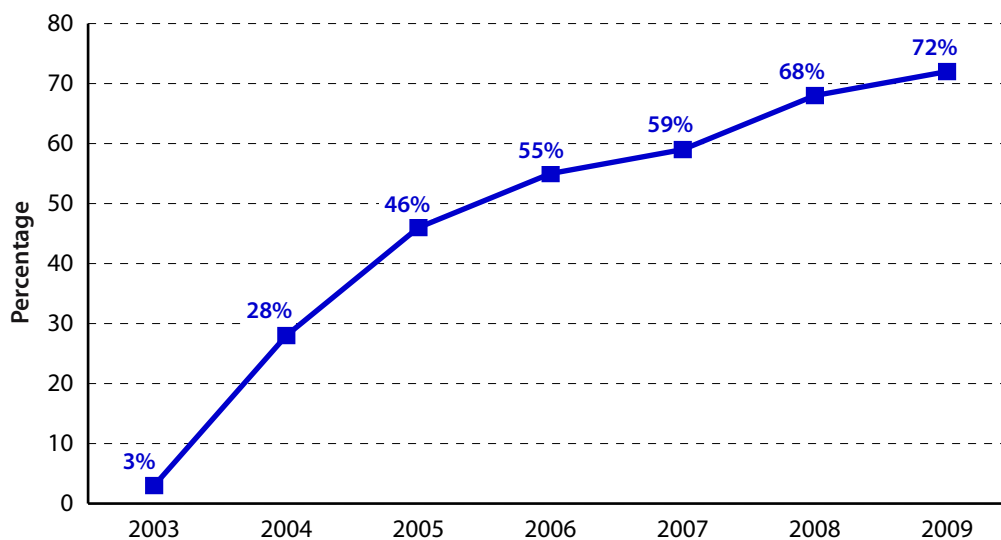
In 2003, the year of the pilot program, the number of prefilled tax returns was 547,431 (figure 5.5), that is, about 3% of all income tax returns (figure 5.6). In 2004, when the program was extended, the number was 4,362,853, which accounts for 28% of all returns. Subsequently, the total number of prefilled returns soars: in 2009 it was 13,872,788, that is, 72% of all tax returns.

To assess more accurately if the prefilled service is useful for taxpayers, it is also important to know the number of prefilled returns confirmed without emendation. This number has also increased greatly as figure 5.7 shows. In 2003, only 29% of pre-filled returns were confirmed. Subsequently, the number of confirmations have increased steadily and, in 2009, accounted for 55% of all prefilled returns. Therefore, the quality of the service can be seen to have again improved.

In conclusion, I think it is quite clear that the results of these help services, first the tax data and later the prefilled tax return, are very positive. They are used by the great bulk of taxpayers. Both services make complying with the tax more simple. The greater the experience with the prefilled return service, the greater the number of taxpayers requesting the service and

**Figure 5.5: Tax data and prefilled tax returns sent, 2003–2009**

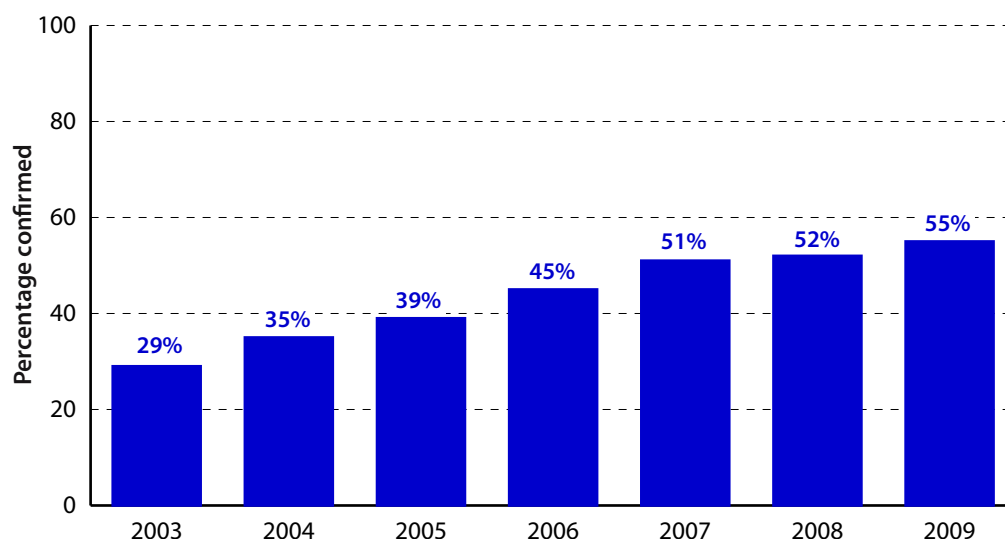
Source: AEAT, 2009.

**Figure 5.6: Number of prefilled tax returns as percentage of all returns, 2003–2009**

Source: AEAT, 2009.

confirming the return. Nonetheless, a prefilled tax return cannot be offered to all taxpayers as the tax agency does not always have enough information to assess the tax base and tax liability. This happens, for instance, with income from property rentals or from personal businesses, where the tax agency cannot know all sources of income or types of expenditures.

In other cases, the tax agency can prepare the prefilled return but it will not be confirmed because some information is missing. For instance, it may be difficult to know if a taxpayer can take advantage of a particular regional tax credit. It depends on the nature of the tax credits—for instance,

**Figure 5.7: Prefilled tax returns confirmed, 2003–2009**

Source: AEAT, 2009.

for nursery expenditures, text-book expenditures, restoration and conservation of regional historical estates—because quite frequently very precise conditions must be met and it is very difficult for the tax administration to have information about them. Consequently, the powerful computing system allows obtaining data from many different sources, which simplifies tax compliance but, at other times, it is the proper regulation of the tax that causes complexity and little can be done by the tax administration to avoid this.

### 3.3.1 *Taxpayers' opinions about receiving tax data by mail and the prefilled tax returns*

According to a survey conducted by a private firm, Bufete de marketing, for the Spanish tax agency, in July 2008, after the two help services had been offered for five years, 94% of the 1,016 taxpayers interviewed preferred receiving the prefilled tax return to receiving only their tax data by mail (AEAT, 2009). Other conclusions from the survey to be noted are:

- the average score given to the prefilled return is 8.05, on a scale of 1 to 10; 22% of taxpayers give the top mark of 10 to the service;
- 40% of taxpayers receiving the prefilled tax return think that the service could not be further improved;
- 95% of taxpayers receiving the prefilled tax return are willing to request the service;
- finally, 90% of taxpayers would recommend other taxpayers to use the prefilled service.

Although I have only had access to a brief summary of the conclusions, it seems quite clear that the great bulk of taxpayers are happy with the pre-filled service.

### 3.4 Electronic filing of tax returns

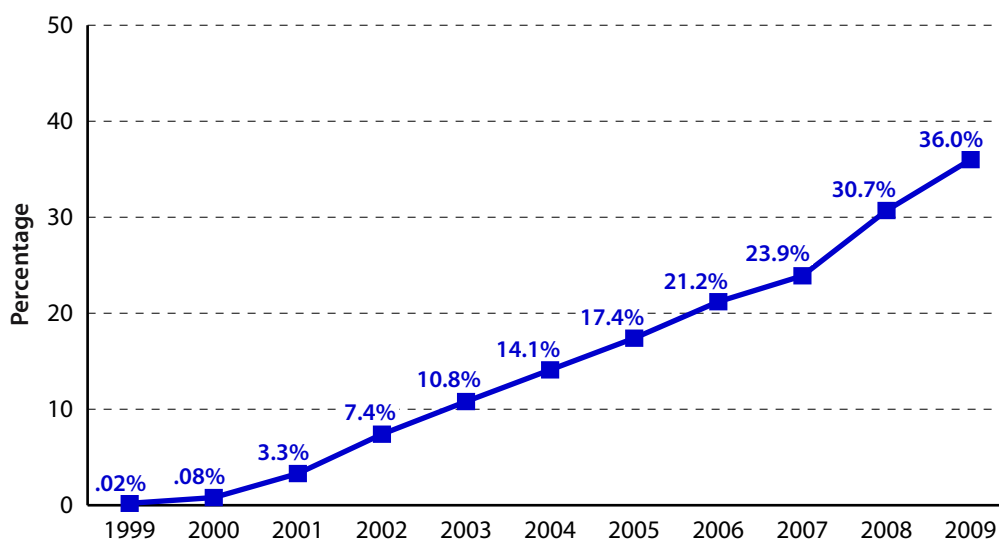
The Spanish tax administration also encourages taxpayers to file returns at the tax agency's virtual office available on the Internet. Taxpayers wishing to use the service need an electronic signature certificate recognized by the tax agency. In addition, taxpayers may assign a proxy or authorize a collaborating institution that has signed an agreement or protocol with the tax agency authorizing them to file tax returns on behalf of third parties. Electronic filling of income tax returns started in 1999 when 21,559 taxpayers chose this option, which accounted for only 0.2% of taxpayers (figure 5.8). Since then the number of tax returns filed via the Internet has soared and, in 2007, this figure was 4,476,786, almost 25% of all taxpayers. And according to provisional data, in 2009 the number rose to 6,913,368 taxpayers, 36% of all taxpayers.

Although it has taken some time for taxpayers to adopt the Internet as a way of submitting an income tax return, it is a very convenient option both for the taxpayer and the tax administrations, which undoubtedly reduces the administrative burden of the tax.

### 3.5 Rapid refund to persons not obliged to file income tax returns

As I said in the brief explanation of the Spanish income tax, the 1999 income tax reform substantially reduced the number of taxpayers with the aim of simplification. The new system to calculate withholding for income from

**Figure 5.8: Income tax forms returned via Internet, percentage of all taxpayers, 1999–2009**



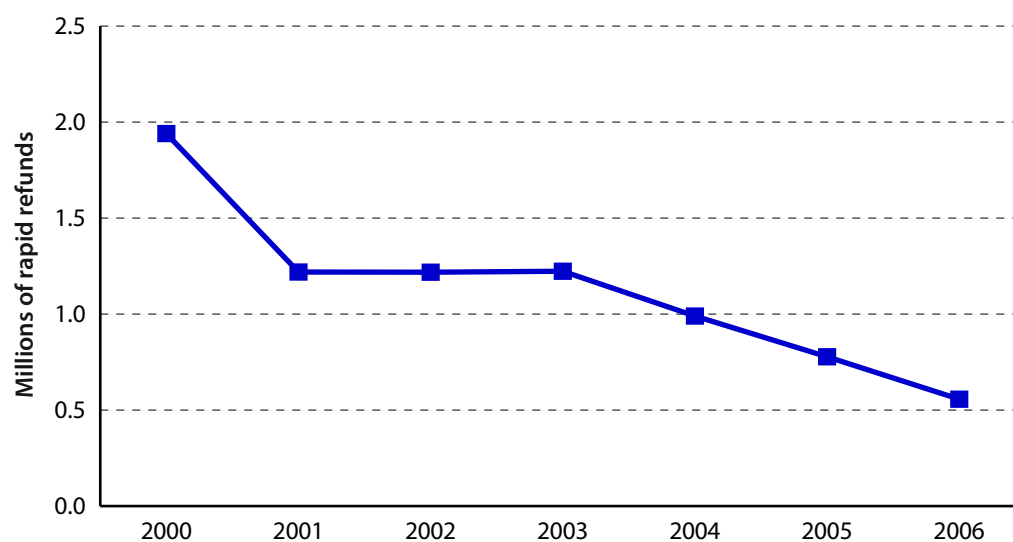
Source: AEAT, various years, *Memoria de la Agencia Tributaria*; press notes; provisional data for 2008 and 2009.

employment was more accurate, so the total amount withheld should be almost the same as the final tax due. At the same time, the number of tax credits was substantially reduced. As a consequence, the number of taxpayers for the 1999 tax year went down by about 18% compared to the previous year.

Nonetheless, in spite of not being obliged to file an income tax return, some persons would be interested in doing so, as they were entitled to a refund. In other words, withholdings were higher than the final liability and they could ask for the excess, but had to calculate their final tax liability to do so. Therefore, the income tax act introduced a new alternative: a simple communication to the tax administration. Indeed, persons not obliged to file a return could send a communication requesting the refund of the amount resulting when the sum of all withholdings at source and amounts paid on account of the payments in instalments made is higher than the tax liability.

For this purpose, the tax agency ran a special campaign for processing refund requests for those who did not have to file an income tax return (on forms 104 and 105). The communication system was first introduced in 1999, and the number of communications (figure 5.9) remained more or less stable for the last years. However, once the prefilled tax return service was introduced, the number of communications fell substantially. Since 2006, the rapid refund communication has been abolished because of its excessive administrative burden. Nonetheless, in practice it is replaced by the prefilled tax return, which, as it was pointed out before, in addition implies an important improvement in the administration of the income tax. This is a good example of how important it is to assess the impact of provided services, as an old one may become meaningless when a new one is offered.

**Figure 5.9: Number of rapid refunds to persons not obliged to file income tax returns, 2000–2006**



Source: AEAT, various years, *Memoria de la Agencia Tributaria*.

## 4 Conclusions

As far as the prefilled income tax return is concerned, the assessment of the Spanish experience is highly positive. In fact, this new help service can be considered as a two-stage process: first, through the mailing of tax data to taxpayers; and second, through the provision of prefilled tax returns, or only tax data if those are not possible. The increasing number of taxpayers requesting the services, the increasing number of confirmations of the prefilled return, and the results of the survey conducted demonstrate that it works well. It would be very interesting to have more official information about the costs of the services but it seems quite clear that the overall result is positive.

Another important issue is that the new services are provided using third-party information reports, but this information was already available for the tax administration. Consequently, the prefilled tax return system does not imply increasing compliance costs for these third parties (e.g., employers). In other cases, the information was already available to other bodies of the public administration and now is also available for the tax administration.

In conclusion, the new service is a clear example that third-party information can be extremely useful both for fighting against tax fraud and for simplifying tax compliance. The improvement and the assessment of the service should be a permanent goal of the tax administration.

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Prefilled Personal Income Tax Returns

# About this publication

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# Acknowledgments

This volume covering five case studies was prepared at the request of the Fraser Institute, which financed the study. We thank Niels Veldhuis for his support throughout, the Fraser Institute for comments on the various papers, and one anonymous referee for extremely insightful comments.

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### ISSN

ISSN 1923-371X Studies in Budget and Tax Policy (print version)

ISSN 1923-3728 Studies in Budget and Tax Policy (online version)

### Date of issue

June 2011

### Citation

Vaillancourt, François (2011). *Prefilled Personal Income Tax Returns: A Comparative Analysis of Australia, Belgium, California, Québec, and Spain*. Studies in Budget and Tax Policy (June). Fraser Institute

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