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Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding Tax Code Complexity and the Tax Gap
As Prepared for Delivery

John F. Kennedy said, "To the extent that some people are dishonest or careless in their dealings with the government, the majority is forced to carry a heavier burden."

In today's tax code, the majority is carrying a heavy burden. It's a burden of hundreds of billions of dollars in taxes that are owed but not paid. It's a burden that prevents us from building new schools or investing in cutting-edge scientific research. It's a burden that keeps us from paying off the debts we owe and reducing our deficits.

According to the latest IRS estimates, the number of tax dollars that are owed but remain unpaid is \$345 billion each year. This disparity is often referred to as the "tax gap." Today, the tax gap equals nearly 20 percent of our forecasted deficit for this fiscal year. In short, the tax gap is more than \$300 billion that we simply can't afford to waste.

Part of the tax gap is the result of tax cheats who simply refuse to comply with the law, which increases burdens on the rest of us. But a portion is due to taxpayer confusion and unintentional errors as well.

We can certainly all agree that the tax code is extremely complex. According to IRS data, U.S. taxpayers and businesses spend more than six billion hours each year complying with the filing requirements of the Internal Revenue Code. As the Taxpayer Advocate's 2010 annual report points out, if the hours Americans spent on tax compliance were instead spent on an industry, it would be one of the largest in the United States. Six billion hours is equal to the work of more than three million full-time employees.

Today's hearing will focus on the issues of tax complexity and the tax gap, as well as the correlation between them.

Does confusion surrounding the complexities of our tax code lead to non-compliance? Can filers simply not figure out the law and how to comply with it? Or is the tax code so confusing because we have patched up loopholes and written new rules in an effort to prevent non-compliance?

First we must ask why people fail to meet their tax obligations. Failure to comply can take three forms: underreporting the amount owed; underpaying the amount a taxpayer acknowledges is owed; and simply not filing at all.

Reports from the Government Accountability Office and the Joint Committee on Taxation have found there are two proven ways to reduce noncompliance – information reporting and withholding.

IRS research supports these findings, demonstrating that more taxes are paid with increased information reporting. When individuals and businesses provide substantial information about spending and income, the compliance rate is over 95 percent. When there is little or no information reporting, the compliance rate drops to 46 percent. However, recent experience suggests that, in some areas, requiring American taxpayers to file additional information reports or withholding taxes is simply too burdensome.

Perhaps there are other solutions. For example, we should ask ourselves: Are there ways the IRS can harness new technology to do more with the same resources?

IRS Commissioner Shulman has proposed changes that would help the agency process tax data more quickly. This upgrade would ensure the IRS has the information it needs to check the accuracy of tax returns immediately after they are submitted. The IRS could identify errors instantly and reduce audits required down the road.

We should also consider ways the tax code is so complex that it actually discourages compliance. In 1987, a year after Congress passed major tax reform legislation, the instruction book for the primary individual income tax form was 56 pages, not light reading by any stretch of the imagination. But by 2009, that figure had grown to 174 pages.

This complexity makes it hard for taxpayers who honestly want to pay their taxes to figure out what they actually owe, and as a result, they often overpay or underpay.

We must do more to understand the sources of the tax gap and compliance burdens so we can make progress uncovering new, creative solutions.

I've said before we should aim to reach a voluntary compliance rate of 90 percent by 2017. To reach that goal, we need to think strategically. How can we reform the tax system so we collect the revenue that is due to the government in the most efficient manner possible? Do we need to tear down the current system and start from scratch? Can we keep the foundation? Do we just need a fresh coat of paint?

So let us consider solutions to close the tax gap that are both creative and efficient. Let us work to reform our tax code in a way that will help us collect more of the taxes that are owed but not paid. And let us continue our work to make the tax code more fair and simple.

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