S. HRG. 117–459

CLOSING THE TAX GAP: LOST REVENUE FROM NONCOMPLIANCE AND THE ROLE OF OFFSHORE TAX EVASION

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDRED SEVENTEENTH CONGRESS

FIRST SESSION

MAY 11, 2021

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PUBLISHING OFFICE

49–445—PDF WASHINGTON : 2022

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CLOSING THE TAX GAP: LOST REVENUE FROM NONCOMPLIANCE AND THE ROLE OF OFFSHORE TAX EVASION

TUESDAY, MAY 11, 2021

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 2:34 p.m., via Webex, in Room SD–215, Dirksen Senate Office Building, Hon. Sheldon Whitehouse (chairman of the subcommittee) presiding.

Present: Senators Wyden, Carper, Brown, Cortez Masto, Warren, Grassley, Portman, and Daines.

Also present: Democratic staff: Michael Evans, Deputy Staff Director and Chief Counsel; and Dan Smith RuBoss, Senior Economic Advisor to Senator Whitehouse. Republican staff: James Williams, Legal Assistant to Senator Thune.

OPENING STATEMENT OF HON. SHELDON WHITEHOUSE, A U.S. SENATOR FROM RHODE ISLAND, CHAIRMAN, SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT, COMMITTEE ON FINANCE

Senator WHITEHOUSE. Let me call this hearing to order. My ranking member, Senator Thune, is not here. A vote has just gone off in the Senate chamber. I was one of the first to vote, and so I am here now, so I can go through some of the rudimentaries of the hearing and welcome our witnesses.

Barry Johnson is the Acting Chief of Research and Analytics at the Internal Revenue Service. Douglas O'Donnell is the Deputy Commissioner for Services and Enforcement at the Internal Revenue Service. J. Russell George is the Treasury Inspector General for Tax Administration. Nina Olson is the executive director of the Center for Taxpayer Rights. And Charles O. Rossotti is a former Commissioner of Internal Revenue, currently a senior advisor at the Carlisle Group.

I am delighted that you are all here, and I guess I will begin with my opening statement, and then that will give the other members a chance to come here.

This is, I think, an important and timely hearing on the tax gap and the related role of offshore tax evasion. My Republican colleagues and I may disagree on what makes a fair tax code, but we very much agree that everyone should pay what they owe. That principle is what today's hearing is about.

The IRS conservatively estimates the tax gap, the difference between taxes that are owed and taxes that are collected, to be $441 billion per year. Commissioner Rettig recently testified that the tax gap may have grown as high as $1 trillion in recent years—trillion with a "t."

One reason for the gulf between the official estimate and Commissioner Rettig's is the bad job the official estimate does in incorporating the so-called "international tax gap" when it is hidden by wealthy individuals and large corporations overseas.

Tracking this offshored money is difficult, but we know there is lots of it. Research suggests the Treasury may lose anywhere from $40 billion to $123 billion every year from offshore tax evasion. Of course, typical American taxpayers do not have the option to hide money abroad, so the wealthy who cheat on their taxes through offshoring also worsen income and wealth inequality.

One study estimates the highest earning 1 percent of taxpayers hide 20 percent of their income and account for 36 percent of unpaid taxes: 1 percent of the taxpayers, 36 percent of the unpaid taxes.

Most Americans pay what they owe, meaning that they cover for the tax cheats through higher taxes, fewer public services, and a larger Federal debt. For large multinational corporations that stretch loopholes beyond recognition to book income to offshore tax havens, the line between legal avoidance and evasion may be paper-thin and may turn on whether an outgunned IRS can defend against the armies of lawyers hell-bent on burying the IRS in litigation.

An outsider looking at these numbers may ask how the most wealthy, powerful country in the world could let this happen. The answer is, we made it happen. Over a decade, Republicans cut the IRS budget by 20 percent, with enforcement hit especially hard.

There are 30 percent fewer enforcement staffers than a decade ago, and the number of highly trained revenue agents who tackle complex audits of the wealthy and large corporations is down nearly 40 percent. The results? Millionaire and billionaire audits dropped over 72 percent. And audits of the largest corporations, those with $20 billion in assets, declined by half. As former Commissioner Koskinen once said, cutting the IRS budget gives a tax cut to tax cheats.

As the IRS budget fell, audit rates for the rich and poor in America converged. The worker receiving the Earned Income Tax Credit is nearly as likely to be audited as a seven-figure earner. What do we do?

Well, we should start with the multi-pronged approach of the Biden administration. First, ensure that the IRS has the resources to collect what taxpayers owe. It needs a larger staff with the knowledge and experience to untangle the networks of shell companies the ultra-rich and large corporations can use to hide their income, often in offshore tax havens.

I would like to explore mandatory funding for the IRS so the agency has sustained and predictable support.

Two, require more reporting of the type of income the super-rich tend to hide. Regular taxpayers cannot hide their wages from the

IRS. They are reported by their employer. The super-rich should not be able to hide them either.

Three, support a technological reboot at the IRS. The agency still relies on some systems from the 1960s. Modern tools and technology could help root out offshore and other types of tax evasion. The investment will pay off. Treasury estimates that $80 billion spent to revitalize the IRS will yield $700 billion in revenues, funding that we could invest in working families. I will note that budget scoring rules block Congress from using that high return investment as a pay-for. That needs to change.

Ramped-up enforcement is essential, but it is no substitute for addressing the fundamental injustice in the tax code, particularly the tax breaks for the ultra-rich and large corporations. For example, my No Tax Breaks for Outsourcing Act would end the incentive for multinational corporations to shift profits offshore.

[The prepared statement of Senator Whitehouse appears in the appendix.]

Senator WHITEHOUSE. I am pleased to be joined by such a distinguished panel of witnesses to discuss the size and scope of the tax gap, the role of offshore tax evasion in that gap, and what we should best do to combat it.

And I don't know—Senator Grassley, are you here in place of Senator Thune, as acting ranker, and wish to make a statement, or should we go ahead and let Senator Thune make his statement when he arrives?

Senator GRASSLEY. Please go ahead.

Senator WHITEHOUSE. Okay; we will do that.

The first witness we will call is Barry Johnson. Mr. Johnson, thank you very much for your participation in this hearing. Please proceed with your testimony.

[Pause.]

Senator WHITEHOUSE. We have to hold on a second while the technical people connect things.

[Pause.]

Senator WHITEHOUSE. We have been hearing about technical difficulties and impediments with the IRS doing its job. We are having technical difficulties with our first witness to sign in.

So why don't we go to a live witness, and we will let the technical stuff catch up with us.

Let me start with Mr. George, please. You are good.

STATEMENT OF HON. J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. GEORGE. Okay; thank you. Chairman Whitehouse, Senator Grassley, and members of the subcommittee (once they arrive), thank you for the opportunity to provide information on the IRS's efforts to address the tax gap.

The tax gap is a longstanding issue that has been a substantial challenge for the IRS. Finding effective solutions to this challenge would yield substantial additional tax revenue. As you noted, Mr. Chairman, the tax gap estimates currently in use are outdated, and the tax gap is likely much higher at this point in time.

IRS studies have shown that audits have the largest impact on tax compliance. The IRS lost 15,000 enforcement employees between 2010 and 2018, which led to a significant reduction in the number of audits, also referred to as examinations.

Over that period, the number of examinations dropped by about 40 percent, even as the number of returns filed grew by 5 percent. Since 2010, the IRS has conducted fewer examinations. Between 2010 and 2018, the share of individual income tax returns examined fell by 46 percent, and the share of corporate income tax returns examined fell by 37 percent.

The percentage decline in the examination rate was larger for higher-income returns. For returns with more than $1 million in total income, the examination rate dropped from 8 percent in 2010 to 3 percent in 2018, a 63-percent decline.

In March 2021, TIGTA reported that the IRS could more effectively prioritize high-income tax payers who owed delinquent taxes but do not pay. In addition, we have also raised concerns that in 2015 the Small Business/Self-Employed Division of the IRS terminated its high-income, high-wealth strategy, which was designed to address high-income taxpayers who had not reported all of their earned income.

Tax gap studies have found that self-employed individuals underreported their net income by 64 percent, which is up from the 2001 estimate of 57 percent. With the growth of online platform companies, it is likely that income and self-employment tax underreporting will continue to be a growing problem.

TIGTA issued an audit report studying the gig economy's impact on tax compliance and the lack of an IRS strategy to address this challenge. We reported that the IRS is not working cases with billions of dollars of potential tax discrepancies involving taxpayers who earned income in the gig economy. Many cases were not selected to be worked by the IRS due to resource constraints and the large volume of discrepancies that were identified.

The use of virtual currency, also called cryptocurrency, is emerging as an alternative asset to U.S. and other currencies. However, we found that it is difficult for the IRS to identify taxpayers with virtual currency transactions because of the lack of third-party information reporting.

Nonpayment of taxes owed is a smaller proportion of the tax gap, estimated to be $39 billion annually. Reductions in resources have also impacted payment compliance. From Fiscal Year 2015 to Fiscal Year 2019, field revenue officers have decreased by approximately 14 percent from 2,612 to 2,239.

Improving international tax compliance remains a challenge for the IRS. The IRS has not developed a reliable estimate of the international tax gap. Non-IRS estimates of the international tax gap vary widely. Previous estimates range from $40 billion to $123 billion annually.

Congress gave the IRS important tools to help stem international tax evasion with the passage of the Foreign Account Tax Compliance Act. It was reported that, after 8 years of spending at least $380 million on IRS systems and efforts to establish international agreements across the globe, the IRS has not taken the compliance actions needed to meaningfully enforce it.

In conclusion, the IRS can more effectively reduce the tax gap by developing compliance strategies for the changing domestic and global economies, and using its resources on information reporting more effectively.

Mr. Chairman, that concludes my statement. Thank you for the opportunity to share my views.

[The prepared statement of Mr. George appears in the appendix.]

Senator WHITEHOUSE. Thank you very much, Mr. George. I appreciate it. And on behalf of myself and also Senator Grassley, who is a long-time friend of the Inspector General community, and a great one for whistleblowing and transparency, let me thank you for your service to our country as Inspector General.

Mr. Johnson is still experiencing some technical difficulties, so we will turn now to Doug O'Donnell, the Deputy Commissioner for Services and Enforcement at the Internal Revenue Service, to make his statement.

Mr. O'Donnell?

STATEMENT OF DOUGLAS O'DONNELL, DEPUTY COMMISSIONER, SERVICES AND ENFORCEMENT, INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. O'DONNELL. Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee, my name is Douglas O'Donnell. Earlier this month, I became the Deputy Commissioner for Services and Enforcement at the IRS. Before stepping into that role, I spent several years as a Commissioner of our Large Business and International Division.

I appreciate the opportunity to testify on the tax gap. My colleague, Barry Johnson, will talk about the technical components of the tax gap and how we measure it. I will discuss what the IRS is doing to address the tax gap, to increase compliance, and to ensure the integrity of our tax system.

Addressing the tax gap requires both service and enforcement. We need to help people who want to comply with the tax laws, and track down those who willfully refuse to fulfill their obligations or commit tax fraud.

The entire IRS workforce is focused on doing the very best we can in both of these areas with the resources that we have. This includes employees who develop clear and understandable forms, instructions, and publications; answer taxpayer questions; process e-filed and paper returns; and audit returns and investigate tax fraud.

Every one of us at the IRS has an important role to play in providing service to taxpayers and ensuring compliance with the tax laws in a fair and impartial manner. But we struggle to keep pace with change.

The size of our economy, the number of taxpayers we serve, the complexity of the tax law, and the global nature of economic interaction account for much of the challenge we face to keep pace. And our ability to deliver on our mission is limited by the level of funding that we receive.

The IRS uses the tax gap to help decide where to deploy our limited resources to minimize the burden on compliant taxpayers, and to concentrate on reaching taxpayers who avoid complying.

Thanks to the help of artificial intelligence, advanced data analytic strategy, and emerging tools, we are able to identify areas of noncompliance in ways that were impossible just a few years ago. With that said, there is room to further modernize these efforts.

The IRS has requested funding to do that. Likewise, the IRS has asked for modernization funding that will allow us to make better use of the data we already collect. Yet we cannot devote all of our resources to just the deepest pockets of noncompliance. It is important that the IRS have a presence in every neighborhood, so to speak.

If the IRS were to stop auditing one segment of the population, then noncompliance in that segment would be more at risk to increase. That is because tax enforcement has not only a direct effect on taxpayers we audit, but also an indirect deterrence effect on taxpayers generally.

To ensure compliance with the tax laws, we are exercising our best efforts, with limited numbers of experienced, specialized examination personnel, covering enforcement from several angles.

In my previous role leading the Large Business and International Division, I was very involved in directing how we would address a wide range of noncompliance, both domestically and internationally. A good example is our Global High Wealth program. This is focused on ensuring tax compliance among the wealthiest taxpayers, those with income or assets in the tens of millions of dollars.

Audits under this program look at the complete picture of an individual and the entities that they control. At LB&I, we worked hard to stretch limited resources to address the two issues that consumed significant examiner time: transfer pricing and the research and experimentation credit. We could improve our risk analysis in both these areas if we had enhanced tools, more data scientists, and additional examiners with subject matter expertise.

In the international arena, we have put a great deal of time and effort into administering the Foreign Account Tax Compliance Act, or FATCA. Congress enacted FATCA to improve our offshore compliance efforts by requiring foreign financial institutions to report information to the IRS about accounts held abroad by U.S. taxpayers.

While increased tax enforcement is critical to addressing the tax gap, making further progress on the tax gap also requires policy and legislative changes to reduce tax law complexity, to increase information reporting, to improve IRS access to development data, and to increase IRS authority in certain areas such as regulating paid tax return preparers, as the President recently proposed.

This concludes my statement. I look forward to hearing from my co-panelists and responding to your questions. Thank you.

[The prepared statement of Mr. O'Donnell appears in the appendix.]

Senator WHITEHOUSE. Thank you very much, Deputy Commissioner O'Donnell.

We have been joined by my distinguished ranking member. We went ahead with the testimony of Inspector General George. We are having technical difficulties that may or may not be resolved with Mr. Johnson. Mr. O'Donnell has just concluded his testimony. So we are two down and three to go. And if you would like to give your opening statement——

Senator THUNE. That is okay, Mr. Chairman. Once you got underway with testimony, that is fine.

Senator WHITEHOUSE. Let me go to Mr. Rossotti, if you don't mind. We are still sorting through Mr. Johnson's technical difficulties.

[Pause.]

Senator WHITEHOUSE. I think you may need to punch your mic button.

Mr. ROSSOTTI. Is that better?

Senator WHITEHOUSE. Much better.

STATEMENT OF HON. CHARLES O. ROSSOTTI, FORMER COMMISSIONER (1997–2002), INTERNAL REVENUE SERVICE, WASHINGTON, DC

Mr. ROSSOTTI. Okay. Well, thank you for allowing me to testify about the tax gap. We estimate that the taxes that were legally owned and not paid were $574 billion in 2019 and will accumulate to $7.5 trillion over 10 years.

This amount is equal to what the lower 90 percent of individuals, 135 million taxpayers, paid in income taxes. And as you know, Commissioner Rettig recently testified that it might be even higher than that.

We estimate that it is practical to recover $1.4 trillion of the tax gap over 10 years, which would still be only 19 percent of the total. In our estimate, all of the gain would be from the top 25 percent of taxpayers, and the majority from the top 3 percent.

Tax compliance is heavily driven by whether a taxpayer's income is reported by third parties in a manner that the information can be efficiently used by the IRS. Where income is reported and it is easily checked in forms like W–2s and 1099s, compliance is 95 to 99 percent. And almost all of that tax is paid voluntarily without any IRS intervention. But when income is not recorded, compliance is as low of 50 percent.

My plan for shrinking this tax gap is based on an integrated three-part program. First, move more of the income from low visibility to high visibility by filling the gaps on income that is not reported by third parties. Second, upgrade IRS technology to make full use of all the information available to the IRS, and to increase the efficiency of all IRS compliance activities. And third, rebuild IRS's skilled workforce, but also provide them technology to resolve cases more rapidly and efficiently.

It is really critical, in our view, to use technology to make the entire IRS compliance process more efficient. Because simply scaling up what the IRS does today will not produce the desired results. As important as audits are, currently all of IRS auditing activity only recovers about 2½ percent of the tax gap.

For example, the IRS today cannot efficiently evaluate information on 40 million K–1 returns, on the 1099–K reports from payers, or on submissions from foreign financial institutions required by FATCA. But modern technology can effectively use this information to identify potential deficiencies more precisely. Technology will also allow the IRS to transform the follow-up process when deficiencies are identified, to one that is far more accurate and efficient for taxpayers and the IRS than traditional auditing.

The technology we are suggesting is not futuristic. It is widely used today, including on a limited scale in the IRS—for example, in screening refunds. But most of the gain in our plan would also come from increased voluntary compliance. So it is essential to make compliance as easy as possible. The technology investments we propose would increase the ease and speed of dealing with the IRS and, very importantly, reduce the number of unnecessary audits.

We also recommend that this committee follow its bipartisan practice of establishing pertinent taxpayer rights whenever it considers legislative authority for the IRS. And our plan proposes several new or clarified taxpayer rights.

Our program would require both authorization and consistent long-term funding from Congress. We recommend a funding increase of about 6 percent per year above what is required to sustain IRS operations. But spreading this increase over 10 years is what will allow the IRS to make effective use of these funds. Over a decade, the investment will produce a revenue gain of about 20 times it cost, and will vastly increase the quality of service the IRS provides the taxpayers.

Implementing a program such as this is challenging. But based on my 50 years of managing programs in business and government, I believe it is achievable and very clearly outbalances any risks.

As Congress did when it passed the IRS Restructuring and Reform Act some years ago, both compliance and service goals can be clearly established. Progress could be measured year by year, and can and should be closely monitored by congressional oversight committees.

I note that our proposals offer long-term investment, and in the short term the IRS certainly must focus on the immediate priorities of the filing season, economic recovery programs, and the new programs such as the Child Credit.

Finally, I believe that fundamental fairness alone is a compelling reason to address this problem, particularly when Congress is contemplating raising taxes on people who already pay what they owe.

That concludes my testimony. Thank you, Mr. Chairman.

[The prepared statement of Mr. Rossotti appears in the appendix.]

Senator WHITEHOUSE. Thank you very much, Commissioner Rossotti. I've got to say, I am on the Budget Committee where we look at 10-year increments, and your testimony that there is a 10-year increment out there of taxes owed but not paid of $7.5 trillion is pretty stunning.

Now let me turn to Ms. Nina Olson, who served for nearly 20 years as the National Taxpayer Advocate, leading an independent organization within the IRS dedicated to assisting taxpayers. She is now the executive director of the Center for Taxpayer Rights.

Ms. Olson, welcome. Thank you for being here. Please proceed with your statement.

STATEMENT OF NINA E. OLSON, EXECUTIVE DIRECTOR, CENTER FOR TAXPAYER RIGHTS, WASHINGTON, DC

Ms. OLSON. Thank you, Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee. I am pleased to appear here today to discuss the Federal tax gap.

To address the tax gap, the IRS needs transformational change. And that change must occur in the context of minimalizing undue taxpayer burden and protecting taxpayer rights. That change also will require significant investment in new technology, leadership, employees, training, and procurement skills. It requires a massive redesign of IRS systems so that they update quickly and can process information and talk to one another in real time.

All of this is not going to happen overnight, but it must occur. If we do not make these investments in the IRS, we will not only not address the upper reaches of the tax gap, but we will actually risk increasing the tax gap by failing to meet the needs of taxpayers who are, in good faith, trying to comply with the law.

There are a few things we should remember as we try to narrow the tax gap. First, we will never close it. We will only narrow it. Second, the drive to enforce the tax laws cannot come at the expense of taxpayer service. Approximately 2 percent of the $3.6 trillion the IRS collects each year comes from direct enforcement actions. The remaining 98 percent comes from the indirect effect of a mix of people's fear of the IRS, and their desire to be compliant with the tax laws.

When these taxpayers have problems, they call the IRS, because dealing with the IRS has consequences that do not accrue to a bad online Amazon or airline transaction. Yet the IRS routinely answers less than 50 percent of calls, and this year, at times, answered only 2 percent of calls to its main 1040 number.

The IRS does not have a 360-degree view of taxpayers' accounts because there is no database in which all taxpayer information is stored or linked, so assistors cannot provide issue resolution to callers. This lack of a full picture of the taxpayer's tax life has significant consequences not only for taxpayer assistance, but also for audit selection, collection prioritization, and protection of taxpayer rights. Taxpayer service, which is so important to achieving the level of compliance we have today, must be funded to maintain that level.

Third, the tax gap does not equal tax evasion. Framing noncompliance as tax evasion not only undermines compliance among the currently compliant who begin to feel naive for complying, but it creates an environment in which IRS staff can feel justified in undermining, if not outright ignoring taxpayer rights and protections.

Tax compliance is a continuum of behavior with many causes, including tax law and procedural complexity, and economic downturns. We should not treat a taxpayer who has simply made a mistake in the same way as the taxpayer who is actively evading tax.

For example, between 2009 and 2018, the IRS offered a series of settlement programs for U.S. taxpayers with unreported foreign bank accounts and income. Although the IRS recovered $11.1 billion from these settlement programs through 2018, just a little over $1 billion a year for 10 years, the data for the 2009 program paints a shocking picture of a regressive penalty structure whereby the taxpayers with the lowest dollar accounts and the least amount of unreported income paid the highest percentage rate of penalty for taxes.

Fourth, intelligent use of data can improve tax administration enormously if it is fit for the purpose intended and used in algorithms and other techniques that mimic human reasoning—and if it does not displace human decision-making and discretion.

Today, IRS data is mired in the 1980s, with some notable exceptions. There is heavy emphasis on data matching and rule-based systems that rarely include feedback loops. Many IRS systems have high false-positive and abatement rates. The IRS also does not use data proactively to alleviate burden and prevent harm to taxpayers. For example, the IRS could use its taxpayer income data and allowable expense guidelines to identify taxpayers who may be at risk of economic hardship and protect them from harmful collection actions.

Finally, proposals to expand information reporting are very promising, but they must be accompanied by taxpayer protections. Bank account information alone is not prima facie evidence of underreporting. Therefore, if Congress authorizes financial account reporting, it should prohibit the IRS's use of this data in its automated underreporting. Congress should also extend the burden or proof protections of section 6201(d) to apply to IRS examination and matching activities.

Thank you very much for the invitation to appear today, and I look forward to answering any questions you may have.

[The prepared statement of Ms. Olson appears in the appendix.]

Senator WHITEHOUSE. Thank you very much, Ms. Olson, and thank you for your long service as our National Taxpayer Advocate. I appreciate that very much.

Let me turn now to my distinguished ranking member, Senator Thune, for any opening comments he should care to make.

OPENING STATEMENT OF HON. JOHN THUNE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator THUNE. Thank you, Chairman Whitehouse. And let me begin by saying I am looking forward to working with you on the subcommittee.

The Subcommittee on Taxation and IRS Oversight covers a number of important issues, perhaps none more so than the responsible stewardship of taxpayer dollars. And I am optimistic we will work to find common ground and common solutions.

Today we are here to discuss the tax gap: what it is, what its components are, and how to reduce it. The chairman also has a particular interest in the role of offshore tax evasion, an important issue as well.

The tax gap is real. Republicans on this committee support closing it. The tax gap, the difference between taxes owed and paid, has been a stubborn problem for decades. The IRS periodically estimates the tax gap, using audits and other data it collects. As of

September 2019, the IRS estimates the average gross tax gap at $441 billion per year for 2011 to 2013. And after late payments and enforcement, I should say, the net tax gap is $381 billion.

While those numbers are improvements from preceding years, the tax gap remains a problem. The IRS Commissioner even speculated that the tax gap could be as much as $1 trillion per year, a number that far exceeds the official IRS estimate.

While that guesstimate might conflate the tax gap with tax evasion, one thing is certain. No one at any income level should believe that they are safe in cheating on their taxes. And we should pursue bipartisan measures to reduce the tax gap and better enforce our tax laws. But any such effort must strike an appropriate balance between taxpayer responsibilities and taxpayer rights.

To address the tax gap, some believe that increased IRS resources, tax audits, and intrusion of a taxpayer's personal information will automatically yield the golden goose of revenue. For example, President Biden recently proposed increasing IRS funding to $80 billion over the next 10 years, projecting those funds would net $700 billion over the decade. Former IRS Commissioner John Koskinen, who served as Commissioner under Presidents Obama and Trump, said he thought that $80 billion was too much. I agree. Based on official estimates about the tax gap and what can reasonably be collected, a return of $700 billion is a tall order as well.

An analysis from the Wharton Business School projected a lower payoff by about $220 billion. CBO estimated that increasing IRS funds for examinations by $40 billion over 10 years would increase revenues by $103 billion, resulting in a net $63-billion decrease in the deficit.

That is not to say that better utilized or enhanced resources could not help find real money, but let's be straight about the return on investment, particularly when those figures are portrayed as offsets for new spending proposals.

Republicans are open to discussions of IRS resources, but those discussions should include measures to improve customer service, ensure existing resources are allocated optimally, and promote smarter and more effective audits. Just as with President Trump's budgets, which also included additional IRS funding and enforcement resources, any increase to the agency should come with commensurate accountability and transparency.

Memories remain fresh of past IRS use of taxpayer resources to disproportionately single out conservative organizations for extra scrutiny. Some on the other side of the aisle will say the Republicans hollowed out the agency's coffers, but IRS budgets have been generally stable for the past 15 years. Any budget reductions are compared to the agency's all-time high budget of 2010, which spiked under all-Democrat rule.

In addition to boosting enforcement, the Biden administration proposes tackling the tax gap by requiring banks to give the IRS new documentation on income from businesses such as partnerships and sole proprietorships, as well as individuals with business income. Under the proposal, the IRS would soon be recovering troves of new data on taxpayers' bank accounts. As you might imagine, many Americans are understandably concerned with the risk of government overreach. More specifically, they are concerned their local banks could turn into extensions of tax enforcement on behalf of the IRS. While we should look at ways to improve reporting, the IRS should better use the information it already receives, like partnership income reports it has collected for years.

Just for everyone to understand, enforcement is only one method to reduce the tax gap. It is actually two degrees of separation between the tax gap estimate and revenue that can be scored from enforcement proposals. CBO budget rules prohibit scoring hoped-for but entirely uncertain revenue from enforcement.

Policy-makers need to be reasonable about what is doable on the persistent problem of the tax gap and the limits of score-keeping rules, particularly for near-term spending proposals.

Finally, while we should find bipartisan ways to reduce the tax gap, it is worth noting that our Nation has a relatively high and stable voluntary tax compliance rate. According to the most recent IRS data, about 84 percent of taxes are paid voluntarily and on time. After enforcement efforts and late payments were taken into account, about 86 percent of taxes were paid. Tax compliance levels remain substantially unchanged since at least the 1980s.

There is not one solution to solving the tax gap, or one type of taxpayer responsible for it. Reducing the tax gap requires a comprehensive strategy and effective execution from the IRS, and appropriate safeguards and accountability to taxpayers.

We have an excellent panel before us. Thank you so much for your testimony. I thank you all for being here, and I look forward to having the opportunity to engage with you in some questions.

Mr. Chairman, I yield back. Thank you.

[The prepared statement of Senator Thune appears in the appendix.]

Senator WHITEHOUSE. Thank you very much, Senator Thune. I look forward to working with you on solving this problem. And I am told, speaking of solving problems, that we have solved the problem of Mr. Johnson's connection. Okay, we are good to go.

Let me ask our last witness—our first witness, now our last witness, Barry Johnson, the Acting Chief of Research and Analytics for the IRS—to make his statement.

STATEMENT OF BARRY JOHNSON, ACTING CHIEF, RESEARCH AND ANALYTICS, INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. JOHNSON. Good afternoon, Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee. Can you hear me?

Senator WHITEHOUSE. Yes.

Mr. JOHNSON. Super. I apologize for the technical problem. My name is Barry Johnson, and I am the IRS's Acting Chief Research and Analytics Officer. I appreciate the opportunity to testify today to discuss my office's work on the tax gap.

I direct the Office of Research, Applied Analytics, and Statistics, or RAAS, within the IRS. We support effective and efficient tax administration by providing strategic research, analytics, statistics, and insight to the IRS business units to inform their decision-making and increase innovation across the agency.

One of the functions of the IRS is to oversee data collection and methodology used to measure the tax gap. As you have heard already, the most recent IRS study of the tax gap was released in 2019. It covered tax years 2011 through 2013 and included methodological improvements that resulted in updates to earlier estimates.

The study estimated that the average annual gross tax gap for that period was $441 billion, and that the voluntary compliance rate was 83.6 percent. We are in the process of preparing a new study on the tax gap covering tax years 2014 to 2016, which will also include projections up to tax year 2019, the last year for which we have data.

We expect to release this report early next year. The gross tax gap estimate of $441 billion does not account for the revenue brought in through enforcement activities such as audits and document matching, as well as late payments.

After factoring in these efforts, the average net tax gap for 2013 is estimated at $381 billion. When looked at by mode of noncompliance, the tax gap can be divided into three components: nonfiling or not filing required returns on time; underreporting, or not reporting one's full tax liability when a return is filed on time; and under-payment, or not paying by the due date the full amount of tax reported on a timely filed return.

By far the largest component of the tax gap is underreporting, representing $352 billion of the $441-billion total. Individual underreporting comprises $245 billion, while employment tax represents $60 billion; corporate taxes, $37 billion; and excise taxes, $1 billion.

The report confirms an important point about the tax gap. The compliance rate is very high for income that is subject to third-party information reporting, and higher still when you have withholding. The net misreporting percentage was just 1 percent for amounts subject to substantial information reporting and withholding, and it was 5 percent for amounts subject to information reporting without withholding.

The net misreporting percentage jumped to 65 percent for income not subject to any information reporting or withholding.

While the IRS's tax gap methodology has been deemed the gold standard by tax administrators around the world, we recognize that the lag between the focus years and the release of the estimate reduces the utility for some purposes.

We are developing improved methodology we believe will produce more timely estimates. Primary research using this methodology that goes from the 2011 to 2013 estimates suggests that the gross tax gap for 2019 will be approximately $600 billion.

We also know that our current methodology primarily captures known factors that contribute to the tax gap based on actual examinations, but may not include emerging issues, issues not disclosed during examinations, certain international issues, and issues that are concentrated in a relatively small portion of the highest-income population.

Recently, researchers explored two such factors used by the very wealthy: offshore accounts and pass-through business entities. Using the findings from this paper, we estimate that underreporting from these sources would add about $33 billion to our 2011 to 2013 tax gap estimates, or about $50 million in tax year 2019.

My written testimony notes several ways the IRS is using data and analytics to improve IRS processes. To ensure that we direct our scarce resources to the most important opportunities, Doug O'Donnell, Deputy Commissioner for Services and Enforcement, and I co-chair our data analytics governance board, which created a small innovation lab that brings together subject matter experts and data scientists to develop solutions to the highest priority cross-cutting challenges.

To date, we have created new tools, techniques, and outreach strategies to help reduce the tax gap and increase voluntary compliance. For example, working with the Taxpayer Advocate Service, we recently developed new online educational materials on employment taxes, and we are testing a soft notice intended to nudge businesses to send in a payment when they appear at risk of becoming noncompliant.

Despite limited resources, the IRS is demonstrating our ability to better use data and analytics to modernize processes and reduce the tax gap. Additional resources to scale up these efforts would enable our hardworking, dedicated staff to make even more progress.

Chairman Whitehouse, Ranking Member Thune, members of the subcommittee, this concludes my statement, and I would be happy to answer your questions.

[The prepared statement of Mr. Johnson appears in the appendix.]

Senator WHITEHOUSE. Thank you so much, Mr. Johnson, and my apologies for the technical difficulties.

Let me ask you—even the conservative IRS estimate of the $441-billion annual tax gap is more than honest taxpayers ought to tolerate. And Commissioner Rettig has testified that it may be as high as $1 trillion.

How do you think the international tax gap fits into that discrepancy between $441 billion and $1 trillion?

Mr. JOHNSON. We do not have—the tax gap estimates include some international activity, but not all. So any estimates that we have been talking about this afternoon—we measure international activity by domestic tax return filers in the general estimates.

We do not include activities from taxpayer investors abroad, and businesses—foreign businesses—in the tax gap estimate, mainly because of the difficulty of trying to collect data using our standard classical methodology for those estimates.

We do hope that, with the new methodology I mentioned, that we will be able to address that in the future. I think that the research I have cited gives some insights into the magnitude of money that is overseas.

We have done some preliminary analysis of the FATCA reporting for 2017, and we find that there are $3.7 trillion in assets that are abroad. And 56 percent of those, or $2 trillion of that, is located in what the OECD would consider to be tax haven countries. And we think that the tax gap attributable to international activities, particularly overseas accounts, could be quite large.

Senator WHITEHOUSE. Is Inspector General George correct that the IRS—I am quoting him here—"has not developed a reliable estimate of the international tax gap"?

Mr. JOHNSON. We have not produced a separate estimate of the tax gap, that's true. And it is partly because it is difficult to define what is really meant by——

Senator WHITEHOUSE. I see that it is not easy, but I think it is important to nail down the starting place that we are at right now.

Mr. Johnson, outside research has suggested that U.S. citizens hold as much as a trillion dollars in offshore tax havens. Do you think that that is a reasonable estimate, or could the number be larger than that?

Mr. JOHNSON. Based on our estimate using the 2017 FATCA reporting, it looks like that number would really be about $2 trillion. So twice that.

Senator WHITEHOUSE. Okay; well, thank you.

A question for Commissioner Rossotti. You described gaps in income not reported that need to be filled. Your testimony describes the importance of filling gaps in income that is not reported. Are there some fairly simple ways that we could help the IRS fill those gaps?

Mr. ROSSOTTI. Well, we have proposed a method to do that, which would be an additional 1099 report on money in and money out of certain financial accounts, which we think would be covering basically the—and we also suggested that be limited to certain taxpayers, meaning the upper-income taxpayers and businesses. We believe, together with the other information the IRS has, and with the new technology, that would go a long way to closing the gap.

I do point out that, even though we estimated our total revenue gain higher than others, at one point $4 trillion, that is only 19 percent of the total over the 10 years. And so my feeling is that with the information reporting, the technology, and the resources, that is not an unreasonable goal over a 10-year period.

Senator WHITEHOUSE. And will you help us define whatever we may need to do legislatively, or by way of oversight, to make sure we close that gap?

Mr. ROSSOTTI. Mr. Chairman, I would be delighted to. I have submitted for the record a rather lengthy document that describes some of our proposals. But those are just a starting point. I mean, we are just private citizens here, but we are trying to help as best we can.

Senator WHITEHOUSE. So one thing I will note as I close out my questioning: we have heard testimony today that 36 percent of missing tax revenues of the tax gap, 36 percent of that comes from 1 percent of the taxpayers. And it comes from the 1 percent of the taxpayers at the top, the high-income 1 percent.

And yet—and yet, the county with the highest audit rate in the United States is a poor, mostly black county in Mississippi, where over half of the taxpayers claimed the Earned Income Tax Credit, and median annual household income is $26,000.

I will now turn to Senator Thune. But before I do, let me read off the list that we have right now of Senators. We have Senator Thune here. We have Senator Brown, who would be next, on the web. We have then Senator Grassley, then Senator Warren, then Senators Portman, Daines, Stabenow, Cortez Masto, and Carper.

Senator Thune?

Senator THUNE. Thank you, Mr. Chairman. And I would be interested in the IRS's answer to your observation about the area, the lower-income area, that gets the greatest attention from the auditors. I think that would be good for them to answer.

Ms. Olson, your written testimony clarifies important distinctions about how the tax gap does not equal tax evasion, and how conflating the phrases can lead to wrong impressions, and possibly incorrect estimates about the tax gap.

Could you tell us more about the distinction between the tax gap and tax evasion, and why it is so important to be clear with the terminology?

Ms. OLSON. I think that there are many causes for the tax gap, which can go from tax law complexity to even procedural complexity, people not understanding what the IRS is requiring of them in terms of submitting documentation. It can go to pure evasion, that asocial form. And it can even be a protest against how money is being used.

There are any number of reasons. And if you treat every single taxpayer the same way, you really risk converting compliant taxpayers into noncompliant taxpayers because they feel that they have been treated badly, poorly.

Senator THUNE. According to the latest official IRS estimates—and this was alluded to in our panel's testimony—the gross tax gap is $441 billion, and you said that. That is before the late payments and enforcement. And after payments and enforcement, the net tax gap is $381 billion.

And again, pointing out earlier this year the IRS Commissioner did speculate at a Finance Committee hearing that the tax gap could approach or exceed $1 trillion, a figure that many have taken as a factual data point. For example, on the day of the hearing, *The New York Times* ran a headline stating "Tax Cheats Cost the U.S. $1 Trillion Per Year, IRS Chief Says."

Even with the rise of virtual currencies and other changes in the economy, these numbers obviously do not square. Mr. Johnson, could you clarify the official IRS estimate of the tax gap?

Mr. JOHNSON. Yes, sir. The official tax gap estimate is $441 billion, the proposed tax gap. That relates to tax years 2011 to 2013. I think the IRS Commissioner was updating that to the present, and I testified earlier that if we do that with just the gross tax gap estimate we have discussed, we get to a tax gap that is $600 billion.

If we add in the little bit extra that was identified as undisclosed, or uncovered in the current estimates of $50 billion, then we are up to $650 billion. Factoring in other issues related to the changes, the structural changes in our economy that have taken place since 2013, the incredible rise of cryptocurrency, the growth of the platform economy, tax schemes like syndicated conservation easements, the micro-captive insurance, I think we would be looking at adding a significant additional amount to the potential tax gap.

Also, we have to keep in mind that, over the last 10 years, IRS audits have fallen, and we know that one of the benefits of IRS audits is that there are direct consequences—we collect more money—but there are also indirect consequences. Others perceive that their risks of being audited are higher, and that might cause them to disclose more information when they are reporting their income and their taxes.

The fact that IRS audits have fallen—and that has been very well publicized—due to the budget cuts, tends to also be having an impact on the deterrence effect.

So I think, when we add all these things together and think about what the tax gap might be today, I do not think that it is unreasonable to speculate it could be as high as the Commissioner's estimate. And that is even before we think about illegal income.

Senator THUNE. And when you talked about the breakdown of the $381 billion, I think you said that $245 billion of that is on the individual side? Did I get that right?

Mr. JOHNSON. That is correct.

Senator THUNE. Okay, so $245 billion. And most of this, you suggest, is underreporting. Give me some examples of that. I understood what the chairman was saying about some of this being offshore accounts that people are not reporting, wealthy folks. Do you have the components or how you compose the $245 billion on the individual side?

Mr. JOHNSON. Sure. I believe I provided a copy of the tax gap map in the written testimony. We estimate that business income makes up $110 billion of that; non-business income, $57 billion of that; credits that are misreported, $42 billion; income offsets, $20 billion; filing status misreporting, $5 billion; and other taxes, about $1 billion.

Senator THUNE. Very quickly, Ms. Olson, as a former IRS watchdog, what do you think about the significantly higher guesstimate and its methodology?

Ms. OLSON. I am very disturbed about guesstimates about the tax gap. I think that sends a message to IRS employees that there are lots of people out there cheating, and so whomever they see, they may view as that. I think that there is a need to do really responsible work. It sounds like the IRS is trying to do that with offshore, but I think we should wait to hear what the actual rigorous methods are.

The article by the NBER has not been peer-reviewed yet, and so I think all of these things need to be taken very carefully.

Senator THUNE. Thank you, Mr. Chairman.

Senator WHITEHOUSE. Thank you very much, Senator Thune.

We will now turn to Senator Brown. And after Senator Brown, if Senator Grassley is not here, we will turn to Senator Warren.

Senator BROWN. Thank you, Chairman Whitehouse and Senator Thune, ranking member; thank you for this hearing.

The 2017 tax law, as we know, gave a huge windfall to owners of so-called pass-through businesses. Contrary to what our Republican colleagues say, these are mostly not small businesses. They are more likely to be hedge funds, real estate interests, and companies like the Trump organization.

The 2017 tax law gave these wealthy taxpayers a huge tax cut. To make matters worse, the IRS has not funded its staff to effectively audit them either.

So, Commissioner Rossotti, in your proposal—explain to us, if you would, how it will help the IRS more effectively target pass-through businesses, the entities that largely drive the tax gap?

Mr. ROSSOTTI. Yes, Senator Brown. So I think one of the observations that underlies our proposal is that over the last, even I would say 40 years, the fraction of business income that is earned in pass-throughs, which was relatively limited, very limited in fact in past years, has become as large as all the corporate income combined.

So it is a large sector. And you know, honestly, the IRS programs for compliance in this sector have not kept up. So what we proposed is really three things, the same as other areas.

We want some additional information reporting—really, one additional information report; secondly, the technology to make use of it. Because right now, even where the IRS has information—for example, K–1s report income from partnerships to individuals, but the IRS has no technological ability to use that. So that is almost $2 trillion of income that is reported but is not checked.

And finally, of course, you need that information to follow up when there are deficiencies that are identified. Because right now, even though the Congress has given IRS some additional authority to use that, the ability of the IRS to use that, and the audit rate, are very, very limited. There is actually negligible auditing in that sector.

So those are some of the proposals that we think could help to identify underreporting in that sector.

Senator BROWN. Thank you, Commissioner. And I can think of no better way to undermine faith in our democracy than to tell working Americans that there are really, when it comes to paying taxes, two sets of rules: one for people like them who pay their taxes, and another for the 1 percent that just about everybody on this panel has mentioned who do not pay close to their fair share. And if that is not bad enough, we obviously said we have a serious infrastructure need that people here want to pay for, and pay for with real tax dollars.

So I have a question to you, Ms. Olson. I want to ask about the EITC. Does the EITC comprise—I heard the chairman's question about Mississippi—or comment. Does the EITC comprise a significant part of the tax gap?

Ms. OLSON. Sir, no. It is about 3.9 percent of the tax gap, if you estimate at $441 billion. And if you take the Commissioner's estimate of $1 trillion, it would be about 1.7 percent——

Senator BROWN. Spread out over lots and lots and lots of taxpayers' portion of the EITC. Would we see fewer improper payments in the EITC returns if the IRS had the authority to establish minimum confidence standards for paid tax preparers?

Ms. OLSON. I think that is a significant provision that would reduce noncompliance in that area, since so much of the returns are procured by paid preparers, and even ghost preparers, people who do not sign returns who are actually getting paid. And there is where you have the highest error rates.

Senator BROWN. Thanks, Ms. Olson.

Presidents of both parties have proposed it in their budget. Congress needs to enact it, with expansions of the EITC and the Child Tax Credit. It is critical that eligible filers take advantage of these—of all of these credits which support them, support workers, support families; and it is a very high priority of this Congress.

Chairman Whitehouse, thank you for allowing me to be a part of this hearing today.

Senator WHITEHOUSE. Thank you very much, Senator Brown. We will turn now to Senator Grassley, followed by a shift in order of Senator Carper, and then Senator Portman.

So, Grassley, Carper, Portman.

Senator GRASSLEY. Ms. Olson, thank you for your long service, before I ask my question—for your good work.

One of the difficulties the IRS has is targeting its limited audit resources at bad actors while not unduly burdening honest taxpayers; in short, avoiding no-change audits.

The IRS whistleblower program has proven to be an effective means of identifying and examining noncompliant taxpayers. As a result, the IRS whistleblower program provides significant bang for the buck. This also benefits honest taxpayers, since they are less subject to hassle from the IRS.

What are your general thoughts on the whistleblower program? Do you agree that a robust whistleblower program must be a part of any effort to reduce the tax gap?

Ms. OLSON. I think the whistleblower program is uniquely designed in the area of offshore. That is where you will, through whistleblowers, get information that you might not be able to achieve elsewhere, and obtain elsewhere.

Senator GRASSLEY. So it is a useful tool?

Ms. OLSON. Yes, absolutely.

Senator GRASSLEY. Mr. George, I have been a proponent of the IRS private debt collection program as one means of closing the tax gap. The program has proven able to collect hundreds of millions of dollars annually that otherwise would go uncollected.

However, as mentioned in your testimony, one issue that injures the program is the old age of accounts assigned to the program. To address this issue, the Taxpayer First Act shortened the time period for when accounts may be assigned to the program after assessment by over 1 year. This shorter timeline became effective beginning in 2021.

Mr. George, can you confirm whether the IRS has implemented this updated time frame for assigning accounts to the program?

Mr. GEORGE. We know that they are taking steps now, Senator, to implement the changes that are required. And, to the extent that they have completed those, I would have to get back to you.

Senator GRASSLEY. Okay; please get back to me.

Also to you, Mr. George: I have long been concerned about the amount of time IRS employees spend on union activity at taxpayers' expense. Sensible standards for granting and using taxpayer-funded union time were imposed during the Trump administration. This resulted in about a 26-percent drop in the number of hours Treasury employees spent on union time.

This equates to the annual workload of about 61 full-time employees. If we are serious about closing the tax gap, a top priority should be ensuring IRS personnel are used effectively. Now the current administration repealed the Trump limitation on this activity.

Mr. George, can you speak to whether Treasury and the IRS have reverted to the pre-Trump policy with regard to union time?

Mr. GEORGE. That I cannot address, Senator, no. I do not have information regarding that. We will look at it, and if we——

Senator GRASSLEY. Can you submit it to me in writing?

Mr. GEORGE. I most definitely will.

Senator GRASSLEY. And my last question to you, Mr. George, and for everybody: I am concerned by a finding in a recent report issued by your office titled, quote, "High-Income Taxpayers Who Owe Delinquent Taxes Could Be More Effectively Prioritized," end of quote.

According to this report, IRS failed to assign 3,185 high-income taxpayer accounts to the private debt collection program, despite meeting the program's eligibility requirement. This suggests that the IRS is not making full use of the private debt collection program.

So my question: do you have any suggestions on how the IRS could improve the process it uses to identify and assign eligible accounts to the program?

Mr. GEORGE. Senator, we have reported that the IRS does receive very dated tax accounts, but provides those to the private debt collection organizations. And the longer, as you well know, you wait to provide those tax accounts to these private debt collectors, the less likely it is that they are going to receive anything from it.

That said, even though, by general standards, the percentage of accounts that are given to private debt collectors is below industry standards in terms of the recovery rate, they are still, the private debt collectors, receiving more money in terms of collecting it from people who owe it than the cost that it is charging to the government.

So giving more quickly accounts for these private debt collectors to address, would help address that problem, among many other factors that could happen.

Senator GRASSLEY. Thank you, Mr. George.

Thank you, Mr. Chairman.

Senator WHITEHOUSE. Thank you very much, Senator Grassley. We will turn now to Senator Carper, followed by Senator Warren.

Senator Carper?

[Pause.]

Senator WHITEHOUSE. Senator Carper just logged off.

Senator Warren?

[Pause.]

Senator CARPER. Mr. Chairman?

Senator WHITEHOUSE. Yes. Proceed, Senator Carper.

Senator CARPER. Thank you so much.

I want to thank you, and I want to thank Senator Thune for convening this important hearing.

I will never forget, as a Congressman a million years ago, every year I hosted a workshop, a budget workshop, with Delawareans from all walks of life to come to a town hall meeting to spend a couple of hours together trying to figure out how to balance the budget.

At one of those meetings I suggested maybe raising the revenues was part of the solution. This one lady sitting in the back of the room said, “I don’t mind paying, I just want to make sure that others are paying their fair share.” I will never forget that conversation.

But for years, former IRS Commissioner John Koskinen, somebody whom I have enormous respect for—and I know others do too—he testified before the Senate Finance Committee about the need for increased resources for additional personnel, updated technology, year after year after year. Unfortunately, much of his testimony fell on deaf ears.

The IRS budget has shrunk, I think since 2010, by something like 20 percent, and the number of revenue agents who specialize in evaluating the complex returns of high-income individuals and corporations has decreased, I am told, by nearly 40 percent.

Last month, my colleagues will recall, our current Commissioner, Chuck Rettig, reiterated the need for additional resources for enforcement. But providing additional appropriations funding to the IRS may not be enough. It is certainly part of what is needed, but an effective enforcement structure at the IRS is going to require sustained and longer-term funding, and certainly predictability.

Last week, five former IRS Commissioners, including you, Mr. Rossotti, penned an op-ed in, I believe it was *The Washington Post,* in support of President Biden’s IRS plan. Mr. Rossotti, thanks for joining us here today.

What components of the President’s plan for the IRS do you think would be most effective for Congress to adopt as we address the tax gap?

Mr. ROSSOTTI. Yes. I think all five of us Commissioners had discussed that editorial before we agreed to sign it, and we think that there are three parts to the administration’s proposal which are, together, what makes for the effectiveness.

There is a need for some additional information reporting to fill some gaps in the types of income that are reported.

Secondly, the administration’s proposal does provide for funding on a long-term basis for technology and for rebuilding staff. And I think those two latter things are really why it is so important to have a sustained effort.

It is not possible in a case like the IRS to put a one-time appropriation. And frankly, you could overdo putting money in too quickly and not be able to get it used effectively.

So I think what is most effective about the administration’s proposal—which we certainly support—is the idea of funding over a 10-year period that would be reasonably assured but not overdone in any one year. Our own estimate that we have made independently is that about a 6-percent a year increase that would cover both technology and staffing would be most effective, and could be readily managed.

Senator CARPER. Thank you, Commissioner.

The second question I have deals with fiscal responsibility and IRS enforcement. I would direct this question to Mr. Johnson and to General Russell George.

Part of maintaining fiscal responsibility is making sure that we have adequate revenues, as we all know. And this includes collecting the taxes that are currently owned under the law.

Commissioner Rettig, who was before us a month or so ago, has estimated that for every additional dollar of enforcement funds, we could bring in somewhere between $5 and $7 in additional revenues. That seems like a pretty good return on investment to me. And I would ask Mr. Johnson and Mr. George, how would robust investments in the IRS enforcement represent an efficient use of taxpayer dollars and raise revenues in a way that improves our long-term fiscal outlook?

Mr. Johnson? Mr. George?

Mr. JOHNSON. Thank you. I can comment on how we produce those revenue estimates. For the return on investment estimates that are produced in my office, in conjunction with the Chief Financial Officer's office, we look at the historic revenue collected by the enforcement staff over the most recent 10-year period, putting more weight on more recent years, because those activities obviously reflect current uses.

And as you noted, the ROI does vary a bit between the different types of taxpayer work that we do, but on average it is about 4 or 5 to 1. And you know, for my money, I would be happy to have any investment that returned 5 to 1 as an average return.

Senator CARPER. I think we would all like a piece of that action.

Mr. George?

Mr. GEORGE. Senator, I would give the following example in response to your question. The IRS's high-income threshold for underreporting is around $200,000. And its threshold for non-filing is $100,000. Average revenue agent productivity on incomes above $10 million is over $4,500 per hour of the revenue agent's time, as compared to a few hundreds of dollars per hour in audits for taxpayers with incomes between $200,000 and $400,000.

The bottom line is, if you give the money so that the expertise can aim towards the group that is in a position better to manipulate their taxes so that their responsibility to the government, I am not saying intentionally is hidden, but that the avoidance versus evasion argument is addressed, the IRS could get a better return on investment for all the dollars that it expends.

Senator CARPER. Thanks.

Mr. George, you remind me of my words at commencement addresses sometimes, when I am talking to graduating seniors. I say, "Aim high. There's more room up there." That would probably be germane here as well.

My thanks to all the witnesses. It is also very nice to see you again. Nice to see you all. Thank you all for joining us today.

Senator WHITEHOUSE. Thank you, Senator Carper.

Next is Senator Warren, then Senator Stabenow.

Senator WARREN. All right. Thanks very much. Thank you.

I am glad we are focusing on the gap between taxes owed and taxes collected. I am introducing a bill with mandatory funding, so that the funding lasts year by year by year, so that the IRS can boost tax enforcement for wealthy individuals and for giant corporations who are some of the biggest tax cheats. And I know that President Biden has a similar proposal.

But funding is not all that the IRS needs to do better enforcement. When a teacher sits down to do her taxes, she relies on a W–2 that tells her exactly how much she earned in wages. Her school sent her this W–2 automatically, and it sent a copy to the IRS as well. And this is called third-party reporting, and it helps the teacher fill out her tax return accurately.

It also helps the IRS do its job, both by making it easier to verify incomes, and by keeping people honest because they know the IRS can spot it if they fudge the numbers.

So, Mr. Rossotti, I want to run through a few examples with you, if we can. If you own your own law firm, is there as much third-party reporting on how much you made as there is for the teacher?

Mr. ROSSOTTI. What most law firms are organized as is partnerships. There is some limited reporting, but it is quite limited on partnerships, where of course for wage earners it is 100-percent reported.

Senator WARREN. Okay. And what about if you own a giant beach-front mansion, and you sell it for a lot more money than you bought it for? In other words, you made capital gains income.

Is the IRS likely to know exactly how much income you received?

Mr. ROSSOTTI. Well, of course you are required to report it as a capital gain, but there is not any third-party reporting in that kind of a transaction.

Senator WARREN. So the IRS has no independent verification of that automatically?

Mr. ROSSOTTI. Not unless it does an audit.

Senator WARREN. Okay. And what about if, instead of selling your mansion, you decide to post it on Craigslist and rent it out? Is the rental income you get likely to be automatically reported to the IRS?

Mr. ROSSOTTI. Same answer. I mean, you are required to report it, of course, but there is no third-party reporting on that transaction, if you just rent the property yourself.

Senator WARREN. Okay. So here's the thing. The kinds of income that the IRS has the least visibility into are the kinds of income that are overwhelmingly concentrated among the very richest taxpayers.

So if you're a teacher, or a construction worker, a bank teller, nearly all of your income comes from wages, and that information is automatically reported to the IRS by your employer. But if you are someone say in the top 1 percent, most of your income is coming from business and capital income, and the IRS is counting on you to follow the honor system when you file your taxes.

So, Mr. Rossotti, as a former Commissioner of the IRS, you saw this first-hand. Let me just ask you, do you think the honor system is working?

Mr. ROSSOTTI. Well, it works to a certain extent, because there is a great deal of income that is not reported by a third party that is still reported by taxpayers. But it is also true, I think as Mr. Johnson noted in his report earlier, that the reporting level on income that is not third-party reported is as low as 50 percent on the kinds of income that you identified, for example.

Senator WARREN. Okay, so——

Mr. ROSSOTTI. So there is a big difference.

Senator WARREN. So I think the conclusion we can draw is that strengthening third-party information reporting would obviously help people file their taxes more easily and more accurately. And frankly, it would make it harder for wealthy tax cheats to get away with hiding their income.

The top 1 percent failed to report, I have heard, more than a fifth of their income—you are saying maybe as much as half—and more than a third of all unpaid Federal income taxes. That cost us an estimated $175 billion in tax revenues last year

So that is why my legislation takes Mr. Rossotti's advice and requires banks and other financial institutions to provide the IRS with information on account-holders' balances. It would fill in the holes that allow the richest taxpayers to underreport their income and skip out on the taxes they owe.

Strengthening information reporting, as well as providing protected and sustained IRS funding, would ensure that we focus enforcement on the biggest fish. This is about making our tax system fair, and about raising the revenue that we need to create opportunity for every kid in America.

Thank you, Mr. Chairman. I yield back my time.

Senator WHITEHOUSE. Thank you very much, Senator Warren.

We will now turn to Senator Stabenow, and then to Senator Daines, who is going to be here.

Senator Stabenow?

Senator STABENOW. Well, thank you so much, Mr. Chairman. This is such an important discussion, and I know that folks in Michigan listening to this right now are certainly scratching their heads, or may be very mad about what they are hearing in terms of the level of scrutiny on their taxes as middle-income working people versus someone who is very, very wealthy.

So let me just start there. As a typical Michigan family goes to work, they earn their pay with their taxes withheld; they are sent a W–2 every year. The IRS knows exactly how much money they make, and how much money they owe.

But as we are talking about today, when you look at households who have more money, more assets, leading to more capital gains income and pass-through income, there is shockingly less oversight by the IRS.

And so it is important enough that we are not talking about how much, how many taxes the wealthy should pay. We are talking about how much they already owe, which I think is really, really important.

And so I know today we are looking at, whether it is Commissioner Rettig's estimate of $1 trillion a year in the tax gap, or $600 billion or $800 billion, or $2 trillion, any of that pretty much adds up to a lot of money. And I think about the things that we could do with that, like extending the Child Tax Credit to permanently lift children out of poverty, or fix our roads and bridges, or critical investments in education and small businesses and manufacturing, and on and on and on. I think we hopefully would all agree that the wealthy should be paying their fair share.

So, Mr. Johnson, my question first would be, can you talk a little bit more about why the top 1 percent account for a disproportionate share of the tax gap and are more likely not to pay their taxes, for whatever reason, than the bottom 50 percent of Americans?

Mr. JOHNSON. I think the best way to think about this is to think about the statistics we talked about earlier. And that is that, when we have information reporting and withholding, the reporting of that income is 99-percent accurate. When we have information reporting without withholding, that information is reported with about 95-percent accuracy. But when we have income that does not have any information reporting at all, that is reported with an accuracy rate of about 45 percent.

And so I think the answer to your question is that, for those taxpayers whose income is primarily made up of income that is subject to substantial reporting and withholding, those folks are more likely to be compliant.

But where people who have more of their income coming from sources where there is not third-party reporting, that is where we see the higher levels of non-reporting. And I think that is consistent with what we have been hearing from other speakers.

Senator STABENOW. Yes; absolutely. It is important for us to consider that; that is for sure.

And, Mr. George, one other thing. As the chairman was talking about—and as was depicted in a ProPublica report—the highest audit rates are located in predominantly black and brown lower-income households in rural counties. Yet the number of audited tax returns of millionaires has fallen by 72 percent—fallen by 72 percent; down from 40,965 millionaire audits in 2012 to just 11,331 in 2020. Similarly, two out of every three of the 755 largest corporations in the country, those with over $20 billion in assets, were not audited last year.

We know that tax evasions using offshore accounts and pass-through entities are techniques mostly employed by the top 1 percent, and the IRS estimates, systemically, tax evasion at the very top to the tune of, as we have heard, about $175 billion annually.

So, Mr. George, we have the data. We understand what is happening. Why is the IRS unable to target these individuals who are deliberately evading the taxes that they owe, but lower-income individuals with less resources, less wealth, less recourse, are subject to audits and costly fees at higher rates from errors or unintentional noncompliance?

Mr. GEORGE. Senator, there are a number of factors that come into play here. Everything from, of course, a lack of resources to where some of the tax examiners are located, physically located, who can do more complex tax returns versus less complex tax returns.

As it relates to the very high-income taxpayer, you need someone to go in and literally physically look at information as it relates to the return; whereas, some very simple taxpayers, in terms of their returns and issues relating to that, could simply be a correspondence audit, a letter sent to them.

And so, when you look at the actual numbers, a lot of the IRS examiners are in areas that have a preponderance of low-income taxpayers. It really is interesting—the IRS, you would think, would be able in this day and age to do things electronically, or in other ways that would not require a physical presence, but unfortunately, in many instances, that is not the case.

Senator STABENOW. Well, we certainly could do better, right? And what you are describing does not make any sense, because— it does not make any sense to anybody listening to this. I think even those who would benefit would have trouble really being able to explain why this is a good idea. You are saying if you make more money and your tax returns are more complex, it is more likely you can get out of paying your taxes, right, than somebody who has a simple form, works hard, has withholding, and is just going to work every day and pay their taxes.

So thank you, Mr. Chairman, for this.

Senator WHITEHOUSE. We will go to Senator Daines, who is here in the room, and then Chairman Wyden will be recognized next.

Senator Daines?

Senator DAINES. Thanks, Chairman Whitehouse. I think it is very safe to say that all Republicans and Democrats oppose tax evasion and support steps to close the tax gap.

Congress supported President Trump's budget proposals to increase IRS funding, as well as the enforcement resources. It incorporated the Congressional Budget Office's recommendations.

I do believe there is room for further bipartisan cooperation to address the tax gap. I do have some concerns about President Biden's proposal to increase the IRS budget by an unprecedented $80 billion over 10 years. I am even more concerned that the administration is using the highly questionable estimate of some $700 billion in revenue raised as a key offset for its latest $2-trillion infrastructure package.

I have not seen the modeling that explains exactly how this $700 billion net revenue would be raised, and to my knowledge, nobody outside the administration has either.

Ms. Olson, former IRS Commissioner Koskinen recently stated that he is not sure if the IRS would be able to use that $80 billion effectively. Would you agree with that statement?

Ms. OLSON. I think that it will be very hard for the IRS to ramp up that quickly. What Commissioner Rossotti has suggested is a sustained increase over what they need to just keep the lights on and do their basic job. And that set-aside over a sustained period of years can bring on the technology and the skilled employees with different skills sets to be able to use that technology wisely

And then the last thing is, it needs continued congressional oversight to make sure that those dollars are applied well. But it needs to be a level increase over a sustained period of years, not a ramp-up that will not be able to do that well.

Senator DAINES. Thanks for your thoughts. A follow-up on that would be that the CBO estimated last year that an additional $40 billion in funding for the IRS would result in a net revenue collection of $63 billion—$40 billion invested and $63 billion collected.

Could you explain how doubling that funding level to $80 billion would magically produce an additional $637 billion in net revenue?

Ms. OLSON. I don't know that. I am not an economist, and I don't know what underlies any of those numbers. If you are focusing on the highest income, so you may get a greater return on investment there than just the basic level of return of investment of four to five; that may be something. But again, I cannot answer where those numbers come from.

Senator DAINES. Yes; we are exploring the gap between $40 billion and $63 billion—$40 billion invested, $63 billion back from CBO, and the administration is suggesting $80 billion would give us $637 billion. That is a huge, huge disconnect.

Mr. Johnson, some of my colleagues across the aisle like to state that low-income individuals are audited at higher rates than high-income individuals. We had Commissioner Rettig before the Finance Committee in mid-April. I think he did a pretty good job of responding to this charge, but I think it is worth highlighting that once again.

My question, Mr. Johnson, is, are you more likely to get audited if you are a low-income taxpayer or a high-income taxpayer?

Mr. JOHNSON. Thanks for the question. I think you are asking what the audit rates are for those different taxpayer groups. And the audit rate for low-income taxpayers is lower as a percentage of all taxpayers in that category than the audit rate for higher-income taxpayers, looking at levels of income.

Senator DAINES. I just wanted to dispel this myth we have heard some of my colleagues suggest that low-income individuals are audited at higher rates than high-income individuals. Of note, according to the IRS, for the record high-income taxpayers—this would be over a million dollars—they are audited at about an 8-percent rate; whereas Earned Income Tax Credit recipients are audited at about 1.12 percent. I just wanted to set the record straight on that. That is data coming from the IRS.

Mr. Chairman, thank you. I yield back my time.

Senator WHITEHOUSE. Thank you very much.

And I have the privilege now to turn to Chairman Wyden.

Senator WYDEN. Thank you very much, Mr. Chairman, and thank you for scheduling a very important hearing, and for your long history of going after these kinds of cases and trying to protect taxpayers.

What I would like to do with our panel—we have a terrific panel here—is to better understand how the IRS uses the tools at its disposal to enforce collection from repeat offenders. I do not believe we have talked about that yet, and what we are talking about is high-income nonfilers with multiple years of unfiled tax returns. And 26 U.S. Code 7203 makes the willful failure to file a tax return, and failure to pay Federal income tax, a crime.

So what we are talking about is high-income individuals with multiple years of unfiled tax returns. And the agency recently estimated there were almost 50,000 high-income nonfilers owing $7.1 billion in taxes, with multiple unfiled returns for tax years 2014 through 2016.

So my question is for you, Mr. O'Donnell. For cases involving high-income nonfilers, people with multiple years of unfiled returns, has the IRS made any recent criminal referrals to the Tax Division of the Department of Justice for the willful failure to file a tax return or pay estimated tax?

Mr. O'DONNELL. Thank you, Senator Wyden. I am uncertain whether or not we have made any criminal referrals to the Department of Justice. I will certainly look into that and get back to you.

But what I can say is that our revenue officers are hard at work out in the field ensuring that high-income nonfilers that we are aware of are being brought into compliance. And we are using all tools available to bring them into compliance. And currently in this environment, where it is very difficult to go into the field, our revenue officers continue to perform that work.

Senator WYDEN. Well, respectfully, Mr. O'Donnell, I do not understand how one can assert that all tools are being used when we are talking about high-income non-filers, multiple years of unfiled returns, an estimate of $7.1 billion in taxes in just 2 years, and you are not aware of whether there were any criminal referrals to the Tax Division of the Department of Justice.

What I would like you to do is to furnish to Chairman Whitehouse and myself, as chairman of the full committee, why this is the case. And you said you were not aware of any. Because I just believe this sends a message that there is not much of a deterrent there. If there have not been any referrals at all—and that is why we are going to need the facts—I would like that to be available to myself as chairman of the full committee, and Chairman Whitehouse within 2 weeks. Will you make that possible?

Mr. O'DONNELL. Yes, Senator, I will. And just to clarify my response, this is my second day in this role, and I am not yet up to speed on that program, but I will certainly get there and be happy to provide the information that you have asked for.

Senator WYDEN. Thank you. And I certainly understand that if you are new there, it takes some time to gather all the facts. But I think you can get a sense of why I think this is a show-stopper kind of question. Repeat offenders, enormous sums of money involved; this is not somebody making a once-in-a-rare-instance kind of mistake. We have to get on top of that. So we will expect to get an explanation within 2 weeks about whether there have been any referrals, and if there have not been, why there have not been—and what is going to be done about it. Okay? Two weeks.

Mr. O'DONNELL. Yes, Senator; will do.

Senator WYDEN. Great. Thank you.

Senator WHITEHOUSE. Thank you very much, Chairman Wyden.

I think we have Senator Cortez Masto standing by electronically, and I would call on her, if she is available.

Senator CORTEZ MASTO. Thank you, Chairman Whitehouse.

Ms. Olson, let me start with you. You recommended in your testimony that the IRS could use data and technology not just to find the taxpayers who are noncompliant, but to help taxpayers ensure they get full access to the benefits that they deserve.

In our last hearing with the IRS Commissioner, I raised that the Advance Child Tax Credit portal should provide ease——

[Garbled audio.]

Senator WHITEHOUSE. Senator Cortez Masto, we are having trouble hearing you in the hearing room. I do not know if there is a sound issue of some kind.

Senator CORTEZ MASTO. Let me try that. Is that better? Can you hear me okay?

Senator WHITEHOUSE. It seems to be better. We hear you, and we will restart the clock.

[Pause.]

Senator WHITEHOUSE. No; still stuck. Your screen is not quite frozen, but moving very, very slowly. Senator Cortez Masto, we are being advised that you might turn off your video and then your voice would be able to come through. Taking advice from me on a technological matter is not the wisest thing.

But there you are, so it worked.

Senator CORTEZ MASTO. Better. Can you hear me okay?

Senator WHITEHOUSE. Yes, we hear you well. Proceed.

Senator CORTEZ MASTO. Wonderful. Thank you. Sorry for the technical difficulty.

Ms. Olson, if you can hear me okay, you recommended in your testimony that the IRS could use data and technology, not just to find those taxpayers who are noncompliant, but to help taxpayers to get the access they deserve.

In our last hearing with the IRS Commissioner, I raised that the Advance Child Tax Credit portal should provide access for taxpayers who find themselves in unique situations, such as domestic violence survivors. So my question to you is, could the portal be designed to help domestic violence survivors get their Advance Child Tax Credit?

Ms. OLSON. Yes; absolutely. I think that because the marital status, the household status where the children reside, would change perhaps with the domestic violence survivors, by the time that the last-filed return has been filed. There should be a portal to allow them to do a simplified electronic filing so that they can update their filing easily. And then also, the change of circumstances portal should allow them to enter their change in marital status, and also where the children are.

And because it is likely that there would be a disagreement between the abuser and the survivor as to where the children are, there needs to be an appeals process, an expedited appeals process, so the survivor and others can come in and submit documentation to show where the children are, and not have to wait until the filing of the next year's tax return in order to get the Advance Credit.

And there are procedures in the IRS like the collection appeals process, where there is a 2- to 3-day turnaround from the appeals officers when they get the case. And the benefit of that is, it minimizes improper payments.

Senator CORTEZ MASTO. Thank you, Ms. Olson. Thank you so much. I really do appreciate that, because this is an area that we need to prioritize. And I knew there was a way to get this done, and I appreciate your comments. I am going to submit the rest for the record.

Thank you, everyone.

Senator WHITEHOUSE. Thank you, Senator Cortez Masto.

I believe that Senator Portman is holding, and I would call on Senator Portman, if he is available.

Senator PORTMAN. Thank you, Chairman Whitehouse, and thanks to the panelists who have come today. I feel that this is a reunion of sorts. Former Commissioner Rossotti, thank you for your continued interest in tax administration and the work you have done over the years as Commissioner. And, Ms. Olson, thank you for your work over the years. I have loved working with you as well, as the Taxpayer Advocate and now with the Center for Taxpayer Rights. And Russell George, hanging in there as our IG for Tax Administration. Thank you, all three of you, for your service.

My first questions are not going to go to any of the three of you, but to Mr. Johnson and Deputy Commissioner O'Donnell regarding the big issue here, which is the tax gap. I understand that has been discussed quite a bit today, so I will not belabor that, except to say that it is confusing seeing so many different predictions as to what the tax gap would be based on different enforcement options and different amounts of funds that could be provided. And I understand you have answered that today.

But what you have not, apparently, answered as much about is your estimated revenues from improved enforcement. So I wonder if you could speak to that a little bit. There are various enforcement numbers out there. One from Larry Summers and Natasha Sarin estimates that a $100-billion investment, along with some other changes they propose, would generate more than a trillion in revenue over 10 years. That is the most generous one, I suppose.

Can you all talk a little about what the limits are? In other words, if these projections just get higher and higher, depending how much more money you put into the IRS, and all of them are significant ratios, where is that balance? Where is the right enforcement leading to the right assistance on the tax gap?

Mr. JOHNSON. So I can start. Thank you for the question, Senator. The estimates of revenues it might help us produce are based on historic tax data. So we look over the last 10 years at the revenues that have been generated by actual workers working on groups of taxpayers that have similar characteristics. So we divide the tax filing community into what we call activity codes, or groups, and we look at the revenue that is brought in based on the hours of work that the revenue officers do. The return on those—or the revenue raised by those officers and agents—varies based on a couple of factors.

First, on the complexity of the return or the tax situation that they are examining, the experience that they have working. And so when we produce revenue estimates of what the impact of an increased investment would be, we take into account the fact that, for the first year or so, a new agent working in the field would not raise very much money. And in fact, they would cost us a bit of money because we have to take someone offline to do training, and we recognize that, for the first year, there is probably a loss on that person.

In the second year, there is some revenue. And then by the third year, we believe that they are working at full capacity. We also recognize that, as we audit larger numbers of cases, a larger percentage of the cases in a particular activity code or group of returns, the return on those cases is going to fall, if we are picking—and we hope we are—the returns that are the most egregiously noncompliant. And as we increase the number, we are going to be working cases that will have lower dollar returns. And so that is also a fact that leads into our estimates that we produce for what the return would be on different kinds of investments. So——

Senator PORTMAN. That must be where the term "diminishing returns" comes from.

Mr. JOHNSON. That is correct. Right.

Senator PORTMAN. That was a joke, Mr. Johnson—diminishing returns.

Well, look, I know the last time Commissioner Rettig was before us, he explained about how the tax gap numbers were still subject to some adjustment. And he specifically said that he was going to ask your Research Division to update its approach to determining the tax gap.

Has that happened? Is the approach you are talking about today the new approach? Or are you still updating your methodology?

Mr. JOHNSON. We are in the course of updating that methodology. So we have been working for about a year and a half on a methodology that relies more on machine learning, or some would call it AI, artificial intelligence, to make greater use of the operational audit data in looking at the tax gap. But traditionally our tax gap estimates have been based on a sample of tax return filings that enable a purposeful audit, and it is just those returns that have been used for this estimation. We believe that by bringing in more of the operational audit data, we will be able to produce estimates that are more timely, and are better able to detect emerging issues.

So our current estimates, those estimates that are official estimates, are based on tax returns that were filed in 2011 to 2013 and were audited in the years after that. The audit statistics that we are going to put out next year will be partially based on a similar sample. But we will also be using this new methodology to update those estimates to provide an estimate of tax year 2019, which is the tax year that we have almost all returns in for now, based on the way returns get filed with the IRS.

Senator PORTMAN. So at the conclusion of this new analysis and looking at your new methodology, will you be able to tell us what you recommend as the right amount of resources to maximize the optimal amount of tax revenue and to close the tax gap?

Mr. JOHNSON. That is not a decision that my office would make. We do hope to be able to supply the information that would enable the business units and the Commissioner, Deputy Commissioner O'Donnell, to make those kinds of decisions. But we hope that the information we get will——

Senator PORTMAN. Can I ask, Deputy Commissioner O'Donnell, is that your hope then, to come up with some suggestions as to the notion of diminishing returns? At some point, the return on the investment is not as great, and there is also the issue of personnel, and the issue of taxpayer rights, and just ensuring that it is done in a way that is appropriate.

So, Deputy Commissioner, are you in a position today to say that you have any sense of what that optimal number might be?

Mr. O'DONNELL. No, Senator, I do not know what the optimal number would be, but I do know that the work that Mr. Johnson's team does to estimate the tax gap helps us understand where to deploy our resources.

We know that those—and we heard from former Commissioner Rossotti on this, but where there is opacity in income sources, and there is low third-party reporting, there is likely to be less compliance. And that is where we would want to put additional resources. The precise number is not clear. We do know we are down 17,000 enforcement personnel over the past decade. And that, we believe, is some barometer of where we would want to get to.

Senator PORTMAN. Yes; okay. Well, certainly I think you will find bipartisan support for some of these efforts to increase personnel and to target these resources appropriately.

Is Commissioner Rossotti, former Commissioner Rossotti, still with us?

Mr. ROSSOTTI. Yes, I am right here.

Senator PORTMAN. Charles, I can't see you, so I am concerned.

Mr. ROSSOTTI. I am here in the hearing room, Senator.

Senator PORTMAN. Let me say, first of all, it is good to hear your voice at least, and I hope to see you visually here in a minute, but talk for a minute, if you could—I am at the end of my time, I am sure, and I appreciate Mr. Chairman indulging me—on the reporting. I agree with you, more reporting is a good idea, generally. On the other hand, there are limits to reporting. It's that same balance we have talked about.

I remember in 2011, expanded Form 1099 for the Affordable Care Act was repealed, and it was very bipartisan because, although it was a component of the health-care law, President Obama knew that it imposed excessive burdens on small businesses.

My question to you is, I guess, can you tell us, is there a way to improve reporting that would have a measurable impact on enforcement while still protecting taxpayer privacy, without being overly burdensome?

Mr. ROSSOTTI. I actually think there is, Senator. And that is something I and several colleagues have been working on for a number of years. It basically would be one additional 1099 on certain financial accounts that would basically backstop all the other 1099s. As it is now, there are actually 22 1099s, and 3 billion 1099s are reported. So everybody is getting a lot of 1099s. The trouble is that there are some significant holes in the less visible kinds of income.

And the difficulty is that in the past—you know, when I was Commissioner, it actually would not have been possible to do what I am suggesting today because the technology did not exist. I can tell you, I actually tried some experiments and they did not work because the technology was just too rule-driven and too specific.

But today you have technology, as actually Mr. Johnson said, that can essentially do part of what a revenue agent would do. I mean, not all of it, but some of it. And that would allow you to use new kinds of information that are not available today.

So, while I think all of the discussion about productivity and scaling up audits is meaningful, I actually am not suggesting that you could make a huge difference in the tax gap no matter how well you scaled up audits.

I really think it is the combination of new kinds of technology using all the information IRS has, supplemented by audits, that actually would make the big difference.

Senator PORTMAN. Great. Well, I appreciate that perspective, and I hope you will continue to work with us as we try to figure out the best way forward here. Again, it is good to have you before us, and thank you for your continued commitment to try to make the

IRS work better. You did that when you were Commissioner, and we appreciate you doing it today.

Thank you, Mr. Chairman.

Senator WHITEHOUSE. Thank you, Senator Portman. We appreciate very much the effort at tax humor, which is not a very well-known category of humor. But I think "point of diminishing returns" sets a pretty high bar within the category of tax humor. So you were entitled to some extra minutes there.

Let me—ending on that note—thank all of the witnesses. Let me actually ask Mr. George, if I may, Inspector General George, for one clarification.

Your testimony today said that as of 2018 the IRS—I am quoting you here—"the IRS has taken virtually no compliance action to meaningfully enforce the Foreign Account Tax Compliance Act."

That was as of 2018. It is now 2021. Do you have any update from that 2018-based observation?

Mr. GEORGE. Well, I would never say that the IRS has done "absolutely nothing" to advance the implementation of that. They are lacking some very basic tools. And one of them is the ability to literally have taxpayers and the entities that they utilize overseas provide information, taxpayer identification numbers, for the IRS to be able to match the information the entity has versus the information that the taxpayer has provided, or perhaps has not provided. And we are literally talking about Social Security numbers in many instances.

The IRS has done a tremendous amount of work in working with nations across the globe to initially get this program off the ground. But the most basic thing lacking, again, is the ability for the IRS to, necessarily, match up the information that it receives, and again, may not receive from one party or the other.

So a light needs to be placed under the IRS to get them moving on that one, sir. And it is, in my book, low-hanging fruit.

Senator WHITEHOUSE. Okay; so some progress has been made, but not enough to be able to say that they have it covered. We need to continue to work on FATCA compliance.

Mr. GEORGE. Correct.

Senator WHITEHOUSE. It's too bad we couldn't put an extra "t" on that. [Laughter.] Then it would say "FATCAT," which would be such an appropriate acronym for it. There, that is my effort at tax humor.

Let me thank all the witnesses. This has been really, really helpful. This is the first hearing of this Finance Subcommittee on Taxation and IRS Oversight under my watch, and I hope that all of them are as successful and have as distinguished and helpful a panel as we have had today, and have the same level of input and engagement from all of our distinguished members.

So with all of that, we will keep the record open—okay, so QFRs as filed will be due a week from today. I hope you will comply. There were specific requests for a response by Chairman Wyden within 2 weeks. I would hope and expect that would be honored.

And with that, the hearing is adjourned. Thank you all very, very much.

[Whereupon, at 4:27 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF HON. J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, DEPARTMENT OF THE TREASURY

Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee, thank you for the opportunity to provide information on the Internal Revenue Service's (IRS) efforts to address the tax gap. The tax gap is a longstanding issue that has been a substantial challenge for the IRS. I first testified on this issue before the Committee on Finance in April 2005. Since then, the Treasury Inspector General for Tax Administration (TIGTA) has performed a significant body of work addressing components of the tax gap as well as related IRS compliance and enforcement programs. Finding effective solutions to address the tax gap and its components would yield substantial additional tax revenue.

TIGTA was created by Congress in 1998 with a statutory mandate of ensuring integrity in America's tax system. It provides independent audit and investigative services to improve the economy, efficiency, and effectiveness of IRS programs and operations. TIGTA's oversight activities are designed to identify high-risk systemic inefficiencies in IRS programs and operations and to investigate exploited weaknesses in tax administration. TIGTA plays a key role working to ensure that the approximately 82,000 IRS employees,[1] who collected more than $3.5 trillion in tax revenue, processed more than 242 million tax returns, and issued more than $736 billion in tax refunds during Fiscal Year (FY) 2020,[2] have done so in an effective and efficient manner while minimizing the risk of waste, fraud, and abuse.

In this section of my testimony, I will discuss a number of challenges facing the IRS in addressing the tax gap and our work to address those challenges.

IMPROVING TAX COMPLIANCE

One of the IRS's key responsibilities is to ensure that taxpayers comply with tax laws. If the IRS can increase the rates of voluntary compliance, it can reduce the tax gap. The tax gap is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year. The gross tax gap, which is the amount that is owed by taxpayers before collections resulting from IRS enforcement actions and other late taxpayer payments taken into account, is estimated to be $441 billion annually.[3] The underreporting of income taxes comprises the largest component of the tax gap at $352 billion annually,[4] with individual taxpayers being responsible for the largest share of the underreporting tax gap at $245 billion. The amounts attributable to nonfiling and nonpayment of taxes at $32 billion and $39 billion, respectively. However, the tax gap estimates are generally outdated because they are for tax years of a decade earlier, so their

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[1] Total IRS staffing as of January 16, 2021. Included in the total are approximately 13,300 seasonal and part-time employees.

[2] IRS, *Management's Discussion and Analysis, Fiscal Year 2020.* The IRS reported that $275 billion in refunds issued in FY 2020 were the result of COVID–19 economic impact payments paid under the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

[3] Hereafter in this testimony, the tax gap refers to the gross tax gap.

[4] Improper payments for the Earned Income Tax Credit and other refundable credits are considered a component of this amount.

usefulness may be limited. Recently, the IRS Commissioner testified that he believes the annual tax gap is at least $1 trillion.[5]

There are a number of different factors that drive voluntary tax compliance. The IRS estimates that information reporting and withholding requirements are significant drivers of tax compliance. For instance, when there is information reporting and withholding at the source, tax compliance is approximately 99 percent. When there is information reporting only, tax compliance is approximately 95 percent. When there is neither withholding nor information reporting, the IRS believes tax compliance is as low as 45 percent.[6]

Sustaining and improving taxpayer compliance is important because small declines in compliance cost the Nation billions of dollars in lost revenue and shift the tax burden away from those who do not pay their taxes onto those who pay their fair share on time every year.

High-Income Taxpayers Could Be More Effectively Prioritized

High-income taxpayers generally have more opportunities to engage in planning to avoid taxes. According to the IRS, high-income non-filers, although fewer in number, contribute to the majority of the non-filer tax gap. In March 2021, TIGTA reported that the IRS could more effectively prioritize high-income taxpayers who owe delinquent taxes but do not pay.[7] Specifically, TIGTA identified 685,555 taxpayers who had a balance due as of May 14, 2019. These taxpayers reported adjusted gross income of $200,000 or more and owed a combined total of $38.5 billion. Because the IRS prioritizes high balance due cases for collection, many of these high-income taxpayers would be included in high-priority work. However, balances due are not generally prioritized by income earned and some improvements could be made to prioritize high-income taxpayers more effectively. TIGTA also found that revenue officer staffing does not always align with locations where the greatest number of high-income cases are located, because the IRS is understaffed in geographic locations where high-income taxpayers with delinquencies are located. While TIGTA recognizes that resources are limited, hiring or reallocating resources to work high-income taxpayer cases with delinquencies in these areas could lead to increased tax compliance as taxpayers realize that the IRS is focusing on taxpayers who can pay their taxes but do not.

We have also been concerned that the Small Business/Self-Employed Division (SB/SE Division) terminated its High-Income/High-Wealth strategy (HIHW) in 2015.[8] The HIHW strategy started in 2010 and was designed to address high-income taxpayers whose total positive income (TPI) was at least $200,000 on Form 1040, *U.S. Individual Income Tax Return,* and who had not reported all of their earned income. The HIHW strategy consisted of two subcategories: filed returns for High Income Underreported taxpayers, and High-Income Non-filers, *i.e.,* taxpayers who had earned income necessitating the filing of a tax return but who have not done so. The SB/SE Division's HIHW strategy was disbanded in 2015 and by the end of FY 2017 the cases pursued under the strategy were closed, though the reasons for the termination of the strategy remain unclear.

However, when the SB/SE Division's HIHW strategy was in place, it was not focused on high-income taxpayers given that individual tax return examination closures with TPI of less than $200,000 represented the majority (73 percent) of the individual returns closed from the strategy for FYs 2015 through 2017. The SB/SE Division did not cease examining high-income taxpayers after the HIHW strategy was disbanded. In fact, in an environment where declining resources have caused a significant decline in all IRS examinations, the percentage of the SB/SE Division's high-income high-wealth examination closures for which TPI was at least $200,000 compared to other audits actually increased from 20 percent in FY 2015 to 26 percent in FY 2019. However, total closures continued to drop during this time due to a reduction in available resources and resulted in actual high-income return closures dropping from 47,024 for FY 2015 to 29,610 for FY 2019 resulting in potential lost assessments totaling $1.9 billion. In addition to the decrease in examination

[5] Testimony of the Commissioner of Internal Revenue, Charles Rettig, *On the Filing Season and COVID–19 Recovery,* Senate Finance Committee (April 13, 2021).
[6] Federal Tax Compliance Research: Tax Gap Estimates Tax Years 2011–2013.
[7] TIGTA, Report No. 2021–30–015, *High-Income Taxpayers Who Owe Delinquent Taxes Could Be More Effectively Prioritized* (March 2021).
[8] TIGTA, Audit No. 201930026, *The IRS Continues Compliance Efforts for High-Income Taxpayers After Disbanding the High-Income High-Wealth Strategy, but With Less Effective Outcomes.* The Final Report for this audit will be issued at a later date.

compliance resources, TIGTA is also concerned that the IRS is less able to track its progress in auditing high-income taxpayers by eliminating the HIHW strategy.

After disbanding the HIHW strategy, the SB/SE Division increased examinations of high-income taxpayers using the discriminant function (DIF), *i.e.,* the algorithm the IRS uses to choose some examinations, rather than maintaining or increasing High Income Underreported examinations. This change, affecting 1,534 taxpayers, resulted in $121.5 million in potential lost assessments for FYs 2018 and 2019.

TIGTA has also identified significant pockets of tax noncompliance among business owners filing Form Schedule C, Profit or Loss From Business (Sole Proprietorship), who showed no revenue but significant losses (losses larger than $100,000).[9] We reviewed 1,142 returns that contained a loss on at least one Schedule C that was equal to or greater than $100,000, and those audits had an average examination assessment of $53,183, which was greater than the examination results of seven of the 10 top SB/SE Division Field Examination function strategies. Additionally, the results of these examinations have demonstrated that these types of returns are more productive than DIF-selected returns. Yet, the SB/SE Division utilizes DIF to select most of its returns for examination. We recommended that the SB/SE Division establish a compliance improvement project to focus on the tax compliance risk of businesses with at least one Schedule C attached, no gross receipts, and more than $100,000 in losses to evaluate it as a new strategy or workstream; however, the SB/SE Division declined.

For Tax Years (TY) 2011 through 2013, the IRS estimated that the portion of the $441 billion tax gap due to underreporters was $352 billion (approximately 80 percent). Of this, $245 billion was from individual tax returns and $37 billion was from corporation income tax returns. Additionally, the portion of the tax gap due to nonfilers was $39 billion (approximately 9 percent). TIGTA reported for TY 2017, numerous business and individual non-filer taxpayers with Form 1099–K, *Payment Card and Third Party Transactions,* income were not identified and cases were not created by the IRS's non-filer programs, and in other cases, they were identified but not worked by the IRS.[10]

Specifically, TIGTA identified 314,586 business taxpayers with $335.5 billion in Form 1099–K income that appeared to have a filing obligation, but were not identified as non-filers by the IRS. The problem is that the IRS cannot use third-party information returns, such as Form 1099–K data, to identify business non-filers and create cases if the taxpayers' accounts are coded as not having an open filing requirement, or no tax account exists because the business has never filed a tax return. TIGTA recommended that the IRS fund and implement a programming revision to its process that identifies these types of business taxpayers. However, the IRS disagreed with this recommendation, citing ultimate approval and implementation of that programming is subject to IRS-wide needs and priorities.

The Large Business and International Division Strives to Identify Corporate Non-Compliance

The IRS has struggled to effectively identify the pockets of tax noncompliance in large corporations. For example, we reported that IRS audits of large corporations using the Discriminant Analysis System (DAS) selection tool[11] had a no-change rate of almost 55 percent.[12] Audits that result in no changes can inefficiently consume IRS resources and burden taxpayers who are compliant with the tax laws. TIGTA analyzed the potential cost for excessive time charged to no-change returns, *i.e.,* time in excess of 200 hours, and estimated that potentially $22.7 million was spent examining no-change returns for time periods in excess of 200 hours.

However, the LB&I Division is aggressively addressing these issues. It is in the process of implementing a strategy to update its DAS System selection tool to improve the no-change rates. Additionally, beginning in 2017, the LB&I Division initi-

[9] TIGTA, Report No. 2020–30–056, *Individual Returns With Large Business Losses and No Income Pose Significant Compliance Risks* (September 2020).

[10] TIGTA, Report No. 2021–30–002, *Billions in Potential Taxes Went Unaddressed From Unfiled Returns and Underreported Income by Taxpayers That Received Form 1099–K Income* (December 2020).

[11] The DAS is a computer model developed to systemically score the examination potential for Form 1120 returns with total assets of $10 million or more. Generally, the higher the score, the greater the audit potential.

[12] A no-change rate is a reflection of the effectiveness of the IRS's examination selection methods. A high no-change rate suggests that the IRS is not selecting the most productive tax returns for examination and may be burdening compliant taxpayers with audits.

ated a strategy to audit more on an issue-based system. The LB&I Division refers to this effort as "Campaigns," which currently cover 57 issues, including virtual currencies, micro-captive insurance, net operating loss carryovers, and many other issues.

Impact of the Internet Platform Companies on Tax Compliance

Tax gap studies have found that self-employed individuals underreported their net income by 64 percent (based on the average for TYs 2008 through 2010), which is up from 57 percent in the TY 2001 estimate. With the growth of online platform companies in recent years, which allow people easy and convenient ways to obtain needed services and others to work as self-employed individuals providing those services, it is likely that income and self-employment tax underreporting will continue to be a growing problem.

TIGTA issued three reports addressing a related problem with information reporting in three emerging industries: the gig economy, virtual currency exchanges and peer-to-peer payment businesses. Internal Revenue Code section 6050W and related Treasury regulations addressed Third-Party Settlement Organizations, who bring buyers and sellers together using the Internet platform and guaranteeing payment for goods and services. The law and Treasury regulations did not require Third-Party Settlement Organizations to issue Form 1099–K, Payment Card and Third Party Network Transactions, unless those transacting business earn at least $20,000 and engage in at least 200 transactions annually.

TIGTA issued an audit report on the gig economy's impact on tax compliance and the lack of an IRS strategy to address this challenge.[13] The gig economy includes online platform companies, such as ride-share companies, which act as facilitators that bring together people offering goods or services with others that need such goods or services. TIGTA reported that the IRS is not working cases with billions of dollars in potential tax discrepancies involving taxpayers who earn income in the gig economy. Many cases were not selected to be worked by the IRS due to resource constraints and the large volume of discrepancies that were identified. Consequently, many taxpayers who earn income in the gig economy do not receive a Form 1099–K; therefore, their income is not reported to the IRS.

Virtual currency is a digital representation of value, other than a representation of the U.S. dollar or a foreign currency ("fiat" currencies), which functions as a unit of account, a store of value, and a medium of exchange.[14] The use of virtual currency as a payment method continues to grow in popularity and is emerging as an alternative asset to U.S. or other fiat currencies. Virtual currencies are often described as "cryptocurrencies" because they use cryptographic protocols to secure transactions recorded on publicly available decentralized ledgers, called "blockchains."[15]

Making payments in virtual currency, instead of fiat currency, may allow users to pay lower transaction fees and achieve faster transfer of funds. However, the use of virtual currency may also allow anonymity in transactions and the possibility of avoiding tax reporting obligations. Taxation compliance risks can arise from willful conduct by a taxpayer (*e.g.,* using virtual currency to evade taxes) or non-willful conduct (*e.g.,* lack of understanding of the taxability of virtual currency transactions, calculation of gain/loss from virtual currency transactions, characterization of income, third-party reporting responsibilities).

Virtual currency exchanges allow virtual currency to be readily exchanged for legal tender, and many of them are also Third-Party Settlement Organizations, meaning they did not have to report transactions to the IRS unless such annual transactions exceeded 200 and exceeded $20,000.[16] While these exchanges are in a position to provide important information for use by the IRS in tax administration, information reporting on virtual currency transactions from the exchanges is lacking. TIGTA found that it is difficult for the IRS to identify taxpayers with virtual currency transactions because of the lack of third-party information reporting that

[13] TIGTA, Report No. 2019–30–0116, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance* (February 2019).

[14] Fiat currency is the name for what is traditionally recognized as currency. Fiat currency is the coin and paper money of a country and designated as its legal tender.

[15] *Commodity Futures Trading Commission v. McDonnell,* 287 F.Supp.3d 213 (E.D. NY 2018).

[16] The American Rescue Plan Act of 2021 reduced this reporting threshold to $600 annually so that these organizations are subject to the same reporting requirements as other businesses.

specifically identifies virtual currency transactions.[17] As of October 2018, both the LB&I and SB/SE Divisions' examination functions have started a small number of examinations of taxpayers based on potential virtual currency issues, and the SB/SE Division's examination function has few known open examinations of virtual currency exchanges.

In addition, the growth of peer-to-peer payment applications (P2P) has greatly enhanced the flow and transfer of funds between users on virtual platforms, making it easier and cheaper to send payments from one person to another. However, the technology presents additional tax compliance challenges in that the payments are not always reported to the IRS and can be hard to detect during an IRS examination. The IRS's tax gap analyses indicate that information reporting is associated with higher voluntary compliance. However, some taxpayers may not report income received via P2P payment applications if they do not believe the IRS has received an information return, such as a Form 1099–K.[18]

TIGTA judgmentally selected eight P2P payment applications and found that these companies appear not to meet the current definition of a third-party settlement organization, and therefore are not required to file Form 1099–K. However, three P2P companies filed 950,965 Forms 1099–K involving $198.6 billion of payments in TY 2017, which included amounts below the reporting thresholds.

The IRS did not always take compliance actions on non-filers of tax returns and underreporters related to P2P payments even when information reporting was available. In total, 169,711 taxpayers potentially did not report up to $29 billion of payments received per Form 1099–K documents issued to them by three P2P payment application companies.

When income information is not reported to the IRS, taxpayers are more likely to be noncompliant. A provision was included in the American Rescue Plan Act of 2021 which addressed a TIGTA recommendation contained in this report by addressing the disparity of information reporting between third-party settlement organizations and other types of businesses. Section 9674 of the American Rescue Plan Act changed the exception for de minimis payments by third-party settlement organizations, reducing the exception threshold to $600 annually so that these organizations are subject to the same reporting requirements as other businesses.[19]

Resources and Their Potential Impact on Enforcement Revenue

According to the Congressional Budget Office (CBO), the appropriations for the IRS fell by about 20 percent (adjusted for inflation) between 2010 and 2018.[20] Approximately 70 percent of the IRS's overall budget is for labor, and the drop in funding thus resulted in a decline in the number of IRS employees over that period, particularly in enforcement. The CBO estimated the amount of funding and staff allocated to enforcement activities has declined by about 30 percent since 2010. The number of employees who work the most complex examination and collection cases experienced especially large declines. Between FYs 2010 and 2018, the number of revenue agents, who handle complex enforcement cases, fell by 35 percent, and the number of revenue officers, who manage difficult collections cases, dropped by 48 percent.[21]

Over the past 5 years, the IRS's budget has increased approximately 6 percent, from $10.7 billion in FY 2015 to $11.3 billion in FY 2019. However, funding for each of the IRS's main budget activities has varied. For example, business systems modernization and taxpayer services budgets have increased 39 percent and 18 percent, respectively, whereas, the funding for enforcement has dropped 2 percent over the same period.

While the IRS experienced a general decline in staffing over the last 5 years, the amount of total enforcement revenue related to the work performed by these compliance employees has not decreased in total. Although enforcement revenue collected increased 6 percent between FYs 2015 and 2019, from $54.2 billion to $57.5 billion,

[17] TIGTA, Report No. 2020–30–066, *The Internal Revenue Service Can Improve Taxpayer Compliance for Virtual Currency Transactions* (September 2020).
[18] TIGTA. Report No. 2021–30–022, *The Internal Revenue Service Faces Challenges in Addressing the Growth of Peer-to-Peer Payment Application Use* (April 2021).
[19] The exception threshold for de minimis payments was previously $20,000 and an aggregate number of transactions exceeding 200.
[20] Congress of the United States, Congressional Budget Office, *Trends in the Internal Revenue Service's Funding and Enforcement* (July 2020).
[21] TIGTA, Report. No. 2021–30–011, *Trends in Compliance Activities Through Fiscal Year 2019* (March 2021).

most of this revenue is collected during the automated collection notice stream in which a series of collection notices are sent to taxpayers owing balances due. Revenue collected by revenue officers in the field for more complicated cases decreased by 24 percent between FYs 2015 and 2019, from $5 billion to $3.8 billion.

Overall, the IRS ended FY 2019 with approximately 74,196 FTEs, a 117 FTE decline from the approximately 74,313 FTE in FY 2018. In addition, the IRS's compliance programs continued to see a reduction in available resources. The Examination staff steadily declined during FYs 2015 through 2019, whereas, the Collection staff fluctuated during the same 5-year period and increased from FY 2018 to 2019.

Reductions in Most Types of Examinations

It is important to note that the IRS's research showed the greatest compliance impact comes from audits. Audits have a strong positive impact on reporting compliance and have the greatest impact on tax compliance.[22] The IRS's primary objective in selecting returns for examination is to promote the highest degree of voluntary compliance. Examination is a vitally important aspect of maintaining a voluntary tax compliance system because approximately 80 percent of the gross tax gap is comprised of underreported tax on timely filed returns.[23] Examinations are the means of detecting and collecting a portion of this tax that is not reported and paid voluntarily. These efforts have a direct impact on the tax gap.

The CBO estimated that the IRS lost 15,000 enforcement employees between 2010 and 2018, which led to a significant reduction in the number of examinations and the number of follow-ups on discrepancies between returns and third-party data. Over that period, the number of examinations dropped by about 40 percent even as the number of returns filed grew by 5 percent. Since 2010, the IRS has conducted fewer examinations. Between 2010 and 2018, the share of individual income tax returns examined fell by 46 percent, and the share of corporate income tax returns examined fell by 37 percent.

Furthermore, the percentage decline in the examination rate was larger for higher income returns. For returns with more than $1 million in total income (before losses were deducted), the examination rate dropped from 8 percent in 2010 to 3 percent in 2018, a 63 percent decline. The examination rate for returns with total positive income of less than $200,000, accounted for over 95 percent of individual returns each year, dropped to 0.6 percent in 2018 from 1.0 percent in 2010.

Nonpayment

The component of the tax gap related to nonpayment of taxes owed is estimated to be $39 billion annually. However, reductions in resources have also impacted payment compliance. From FY 2015 to FY 2019, field revenue officers have decreased by approximately 14 percent (from 2,612 to 2,239).

As required by the Fixing America's Surface Transportation Act,[24] the IRS began using private collection agencies (PCA) and implemented the Private Debt Collection (PDC) program. In two prior attempts, PDC programs did not generate sufficient revenue to cover costs and the IRS terminated the programs early with net losses to the Government.

The Joint Committee on Taxation estimated that the current PDC program would yield approximately $2.4 billion in additional revenue through FY 2025. From the launch of the PDC program in 2016 through September 2019, the program generated revenue totaling $358 million ($276 million in commissionable payments, $27 million in non-commissionable payments, and $55 million in Special Compliance Personnel Program revenue), resulting in net revenue to the General Fund/Treasury of $220 million.[25] From 2016 through FY 2019, the program's total cost was $132 million. These collections reflected 2 percent of the total outstanding tax liability assigned to the program, which is well below the national average for the collection of delinquent debts of 9 percent. While the private collection agencies working in this initiative have performed well in terms of the quality of their interactions with taxpayers, TIGTA reported that delinquent accounts assigned to private collection

[22] IRS, The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results (November 2002).

[23] IRS, Publication 1415, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013 (September 2019).

[24] Pub. L. No. 114–94, 129 Stat. 1312 (2015).

[25] Net revenue to the General Fund/Treasury is the total revenue (commissionable payments, non-commissionable payments, and Special Compliance Personnel Program revenue) minus retained earnings. Retained earnings are 50 percent of commissionable payments.

agencies had an average age of 4.75 years. Cases this old are generally uncollectible, and this may explain why the PDC collections are below the national average.[26]

Improving International Tax Compliance

The IRS has not developed a reliable estimate of the international tax gap. The tax gap is estimated using statistics from the IRS's National Research Program data that does not measure international noncompliance. Non-IRS estimates of the international tax gap vary widely (from $40 billion to $123 billion annually).[27] In 2008, the then-Commissioner of Internal Revenue indicated that the IRS had not measured the international tax gap using other methodologies and did not have an estimate for the number.[28] Complexity and change in the international tax environment require that the IRS collaborate with tax administrations of foreign countries to enforce compliance. International agreements and tax law changes are important, but the Department of the Treasury and the IRS should follow through to ensure that these efforts achieve their intended results.

For example, TIGTA reported in 2018 that after 8 years and spending at least $380 million on IRS systems and efforts to establish international agreements across the globe, the IRS had taken virtually no compliance actions to meaningfully enforce the Foreign Account Tax Compliance Act (FATCA).[29] FATCA was designed to establish reporting requirements for U.S. citizens with foreign accounts, with significant penalties if foreign accounts were not reported. It was estimated that revenue from FATCA would be $8.7 billion from FYs 2010 to 2020. While initial enforcement-related complications involved data reliability issues, more recent problems are related to the fact that the Department of the Treasury and the IRS have delayed the requirement for Foreign Financial Intermediaries (FFI) to require that United States citizens provide Social Security Numbers when establishing accounts and the FFIs to provide that information to the United States so that the IRS can match compliance information it has with information that the FFIs have.

The IRS must follow through on global tax cooperation efforts and tax administration practices that can prevent and resolve disputes among countries to increase certainty for taxpayers. In most cases, foreign persons[30] are subject to U.S. tax of 30 percent[31] on their U.S. source income. The U.S. tax owed is generally withheld from payments made to foreign persons by a withholding agent.[32] Withholding agents are required to file Forms 1042–S, Foreign Person's U.S. Source Income Subject to Withholding, to report on an individual taxpayer basis the income and withholding for each foreign person. For Tax Year 2017, the IRS received 6.3 million Forms 1042–S from 49,618 withholding agents.

In response to our prior recommendations, the IRS has implemented processes to improve its identification of reporting discrepancies for Federal tax withheld on U.S. source income paid to foreign individuals. However, these processes did not identify some withholding tax discrepancies. TIGTA reported that IRS processes did not identify 1,919 withholding agents with reporting discrepancies totaling more than $182.7 million.[33] Our review also identified 366 withholding agents that claimed $506 million more in credits for tax withheld than was reported on the Forms 1042–S.

[26] TIGTA, Report No. 2019–30–018, *Fiscal Year 2019 Biannual Independent Assessment of Private Collection Agency Performance* (December 2018).

[27] TIGTA, Report No. 2009–IE–R001, *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (January 2009).

[28] Comments of Douglas Shulman, Commissioner of Internal Revenue, 21st Annual George Washington University International Tax Conference, IR–2008–37 News Release, December 8, 2008.

[29] TIGTA, Report No. 2018–30–040, *Despite Spending $380 Million, the IRS Is Still Not Prepared to Enforce Compliance With the Foreign Account Tax Compliance Act* (July 2018).

[30] A foreign individual is any person that is not a U.S. person, including a nonresident alien, a foreign corporation, a foreign partnership, a foreign trust, or a foreign estate.

[31] A reduced rate, including exemption, may apply when there is a tax treaty between the United States and the country of residence for the foreign individual.

[32] A withholding agent is any U.S. or foreign entity (individual, corporation, partnership, etc.) that takes receipt of, has control or custody of, or disposes of or makes a payment of any income to a foreign individual that is subject to withholding.

[33] TIGTA, Report No. 2020–40–021, *Continued Efforts Are Needed to Address Billions of Dollars in Reporting and Payment Discrepancies Relating to Tax Withheld From Foreign Persons* (June 2020).

In addition, partnerships conducting business in the United States are required to withhold taxes on certain income paid to foreign partners.[34] The withholding serves as an incentive for foreign partners to file the appropriate U.S. tax return. However, TIGTA reported that the IRS's compliance efforts in this area can be improved.[35] TIGTA identified significant errors in the database that the IRS uses to track withholding reported by partnerships. As a result, the IRS's ability is limited to verifying withholding credits and accurately identifying potential non-filers.

Foreign individuals are also required to pay tax related to the sale of U.S. real estate. Specifically, the Foreign Investment in Real Property Tax Act of 1980[36] (FIRPTA) imposes an income tax on foreign persons selling U.S. real property interests. Buyers are required to withhold a percentage of the anticipated taxes due on the amount realized from the sale. A foreign seller of U.S. property can claim a credit for the tax withheld by the buyer. If the seller's tax liability is less than the amount of tax withheld, the seller gets a refund of the difference. TIGTA reported that the IRS's reconciliation processes do not effectively identify and address FIRPTA reporting and payment noncompliance.[37] TIGTA identified 2,988 buyers with discrepancies of more than $688 million between the withholding reported on Forms 8288–A, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests, filed during Processing Year 2017 and the withholding assessed to the buyer's tax account. Extensive data inaccuracies in the FIRPTA database, incorrect and unclear guidelines, and employee errors contributed to these discrepancies.

The IRS also has not established processes to use Form 1099–S, Proceeds from Real Estate Transactions, to identify buyers that do not report and pay FIRPTA withholdings. TIGTA's analysis of Forms 1099–S for TY 2017 identified approximately $22 million in FIRPTA withholding that was not reported and paid to the IRS. Finally, employee errors resulted in 1,835 foreign individuals potentially receiving more than $60 million in FIRPTA withholding credits than they were entitled.

With the rising number of taxpayers giving up or abandoning their U.S. citizen or resident status, it is important that the IRS have controls in place to enforce the tax provisions applicable to expatriates. Since the Heroes Earnings Assistance and Relief Tax Act of 2008, the number of taxpayers expatriating increased significantly from Calendar Year 2008 through Calendar Year 2018 (from 312 to 3,974). During the same period, TIGTA found that the IRS did not have a centralized compliance effort aimed at enforcing the expatriate rules.[38]

Expatriates are required to file Form 8854, Initial and Annual Expatriation Statement, to certify that they have been in compliance with all Federal tax laws during the 5 years preceding the year of expatriation. However, TIGTA found that the IRS database of expatriates was incomplete for 16,798 expatriates who did not file Form 8854. In addition, TIGTA found instances of potential nonfiling, underreporting of income, and/or payment compliance issues by expatriates. From a sample of 26 expatriates who did not file a Form 8854, five had potential unreported income over $6 million. From a sample of 61 expatriates who filed a Form 8854, 15 had potential unreported income over $17 million. Lastly, TIGTA also found that expatriates with high net worth appear to not be paying their exit tax.

We appreciate the opportunity to testify on the topic of the tax gap and the related IRS enforcement efforts. We plan to provide continuing audit, investigative, and inspections and evaluations coverage of these very important issues.

Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee, thank you for the opportunity to share my views.

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[34] A foreign partner can be a foreign corporation, foreign partnership, and any other person who is not a U.S. citizen.

[35] TIGTA, Report No. 2020–30–026, *Withholding Compliance Efforts for Partnerships With Foreign Partners Can Be Improved* (June 2020).

[36] Enacted as Subtitle C of Title XI (the Revenue Adjustments Act of 1980) of the Omnibus Reconciliation Act of 1980, Pub. L. No. 96–499, 94 Stat. 2599, 2682 (December 5, 1980).

[37] TIGTA, Report No. 2020–40–014, *Millions of Dollars in Discrepancies in Tax Withholding Required by the Foreign Investment in Real Property Tax Act Are Not Being Identified or Addressed* (March 2020).

[38] TIGTA, Report No. 2020–30–071, *More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions* (September 2020).

QUESTIONS SUBMITTED FOR THE RECORD TO HON. J. RUSSELL GEORGE

QUESTIONS SUBMITTED BY HON. CHUCK GRASSLEY

Question. I've been a proponent of the IRS private debt collection program as one means of closing the tax gap. The program has proven able to collect hundreds of millions of dollars annually. Moreover, its success has contributed additional resources to the IRS, which IRS has used to hire a couple hundred compliance personnel. As a result, the program contributed nearly $460 million in net revenue to the Treasury in FY 2020 alone. However, as you mention in your testimony, one issue that may hinder the program is the old age of accounts assigned to the program. To address this issue, as part of the Taxpayer First Act, the time period for when accounts may be assigned to the program was shortened from over 3 years after assessment to 2 years. This shorter timeline became effective at the beginning of 2021. Mr. George has the IRS has updated its pool of eligible accounts for the program based on this updated timeline?

Answer. We have confirmed that the IRS completed the programming changes to IRS systems such that accounts that are 2 years past the assessment date are now included in private debt collection inventory, and these cases were in the process of being sent to the private collection agencies. However, we also learned that delinquent accounts are not currently being assigned to private collection agencies because new contracts with the four collection agencies are currently being developed. We will continue to monitor these developments.

UNION ACTIVITIES

Question. I've long been concerned about the amount of time IRS employees spend on union activity at taxpayer's expense. Sensible standards for granting and using taxpayer-funded union time were imposed during the Trump administration. This resulted in about a 26-percent drop in the number of hours Treasury employees spent on union time. This equates to the annual workload of about 61 full-time employees. If we're serious about closing the tax gap, a top priority should be ensuring IRS personnel are used effectively. Now, the current administration repealed the Trump-era limitation on this activity. Can you speak to whether Treasury and the IRS have reverted to the pre-Trump policies with regard to union time?

Answer. Mid-term negotiations between the IRS and the National Treasury Employees Union (NTEU) resulted in changes to their current national agreement. These changes went into effect on October 1, 2018. As you noted during the hearing, the number of hours IRS employees spent on union time decreased after these changes were implemented. IRS management stated that they are following the current national agreement regarding the use of official union time. However, the current agreement expires on October 1, 2021. Therefore, the IRS and the NTEU are currently negotiating a new collective bargaining agreement. These negotiations include limits on the use of official union time. IRS management stated their opening bargaining position is maintaining the level of union time that is included in the current agreement. As of this writing, the IRS and the NTEU have not reverted to pre-2018 policies with regard to union time.

PRIVATE DEBT COLLECTION

Question. I've been a proponent of the IRS private debt collection program as one means of closing the tax gap. The program has proven able to collect hundreds of millions of dollars annually that otherwise would go uncollected. However, as mentioned in your testimony, one issue that hinders the program is the old age of accounts assigned to the program. To address this issue, the Taxpayer First Act shortened the time period for when accounts may be assigned to the program after assessment by over one year. This shorter timeline became effective beginning in 2021. Can you confirm whether the IRS has implemented this updated time frame for assigning accounts to the program?

Answer. The Taxpayer First Act provision shortening the time frame for assigning accounts to the program was effective January 1, 2021, and the IRS has stated that it has implemented the provisions. We will be conducting the Private Debt Collection Performance Review this year, and we will verify that the IRS has effectively implemented these provisions.

Question. I'm concerned by a finding in a recent report issued by your office titled "High-Income Taxpayers Who Owe Delinquent Taxes Could Be More Effectively Prioritized." According to this report, IRS failed to assign 3,185 high-income taxpayer accounts to the private debt collection program, despite meeting the program's eligibility requirements. This suggests that the IRS is not making full use of the private debt collection program. So my question, do you have any suggestions on how the IRS could improve the process it uses to identify and assign eligible accounts to the program?

Answer. In our report, we identified 3,185 high-income taxpayer accounts that were shelved. We believe these accounts should be prioritized by the IRS and worked by IRS revenue officers, because these taxpayers have the ability to pay but are intentionally not paying. However, if the IRS cannot work the cases due to resource issues, at a minimum they should assign these cases to private debt collection agencies. The IRS will not be able to take this action unless the IRS is willing to identify and prioritize high-income taxpayers who are not paying the taxes that they owe. Currently, the IRS is only prioritizing cases by the size of balances that are due.

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. According to official IRS data and research, overall tax compliance rates have been holding steady around 85 percent since the 1980s (voluntary tax compliance around 82–84 percent and net tax compliance around 85–86 percent with late payments and enforcement). That is a relatively high and stable compliance rate for at least 40 years.

GAO has recommended a long-term, quantitative goal for improving taxpayer compliance (ex. 85 percent, 86 percent, 87 percent, etc.). What are your thoughts about GAO's numerical target proposal?

Answer. We agree with the GAO that specific goals can be helpful in focusing an organization on improvement opportunities. However, with respect to the goal of improving taxpayer compliance, there are two determinants that rise above all others in importance: information reporting and income tax withholding. When there is third-party information reporting and withholding, tax compliance is approximately 99 percent. By expanding information reporting and withholding obligations to fit the emerging economies (*e.g.,* the gig economy, virtual currencies and peer-to-peer payment applications), Congress could enable the IRS to achieve significant improvements in tax compliance.

With respect to performance goals, the IRS can set high-level performance goals at the program level, but Congress prohibited the IRS from using records of tax enforcement results (ROTERS) to evaluate employees or to impose or suggest production quotas or goals with respect to such employees (IRS Restructuring and Reform Act of 1998, section 1204(a)). While numerical goals at a program level can be useful to foster improvement, it is important that such goals are accompanied with sufficient resources and a road map to reach those goals. Otherwise, such goals can drive objectionable behavior.

Question. As part of the bipartisan Taxpayer First Act, which passed in 2019, the IRS is required to develop a thorough strategy for customer service. How is the IRS following-through and executing on that strategy? What improvements can be made?

Answer. The IRS submitted its report to Congress on January 11, 2021, and it contained improvement strategies for customer service (known as the taxpayer experience), employee training, and organizational design. The taxpayer experience strategy is the largest strategy with estimated implementation costs of over $1.2 billion over the next 5 years. The taxpayer experience strategy includes: expanding digital services to provide self-service; increasing outreach and education; reaching more underserved communities; and increasing the use of advanced analytics to develop an agency-wide understanding of the taxpayer experience, emerging needs, and operational data.

The IRS has begun building the Taxpayer Experience Office and has named the Chief Taxpayer Experience Officer. TIGTA plans to audit this area during implementation to help ensure that any potential issues are identified early in the process and potentially make recommendations that can be timely implemented.

Question. Can you discuss the role and importance of high-quality IRS customer service and how it helps voluntary tax compliance? What are up to three recommendations you have for the IRS to improve its customer service to taxpayers?

Answer. Taxpayers have multiple options to choose from when they need assistance from the IRS, including assistance through the toll-free telephone lines, face-to-face assistance at the Taxpayer Assistance Centers (TAC) or Volunteer Program sites, and self-assistance through *IRS.gov* and various other social media channels (*e.g.,* Twitter, Facebook, and YouTube).

Providing taxpayers with quality customer service is a key component in the IRS's mission. Ensuring that taxpayers understand and meet their tax responsibilities is crucial for the IRS in its effort to encourage voluntary compliance with the tax laws. Resolving questions before tax returns are filed helps taxpayers avoid unintentional errors and noncompliance, and reduces the burden on both taxpayers and the IRS that results from the issuance of notices and correspondence.

The IRS's goal of providing world-class service to taxpayers hinges on the theory that, if the IRS provides the right mix of education, support, and up-front problem solving to taxpayers, the overall rate of voluntary compliance with the tax laws will increase. The compliance program (examining tax returns and collecting tax liabilities) would then address those taxpayers who purposefully did not comply. However, providing high- quality customer service continues to be a challenge to the IRS.

We have made many recommendations that will assist the IRS in improving its customer service to taxpayers. The following are three recent recommendations we have made in this area:

- Develop processes and procedures that provide taxpayers with the opportunity to self-correct errors on accepted electronically filed (e-filed) returns that are suspended from processing for manual error resolution. These processes can reduce unnecessary burden on the taxpayers and improve the efficiency and effectiveness of tax return processing. For example, some e-filed returns with a missing form are rejected to provide the taxpayer the opportunity to self-correct the error (*i.e.,* attach the missing form and resubmit the e-file return) while others are accepted and sent to the Error Resolution System for manual correction by an IRS tax examiner, which suspends the return and holds the refund until the error condition is resolved. Allowing the taxpayer to self-correct can reduce delays in obtaining their refunds.
- Create a closing code to be entered into a tax account when a refund inquiry is closed that denotes the cause of the refund being misdirected (*i.e.,* IRS error, taxpayer error, or bank error). The addition of this code would enable the IRS to monitor compliance with section 1407 of the Taxpayer First Act. Section 1407 of the Taxpayer First Act requires the IRS to establish procedures to assist taxpayers when a direct deposit refund was not transferred to the taxpayer's bank account.
- Develop a long-term recruitment strategy in an effort to ensure that the remaining Tax Processing Centers after consolidation are sufficiently staffed. This strategy should also include contingency plans to address hiring shortages. IRS management has not adequately addressed the increasing risk related to the inability to recruit and retain sufficient Submission Processing function personnel needed to handle the increased workload being transferred to the remaining Tax Processing Centers as it continues its consolidation efforts. Given the IRS's continued inability to meet its hiring goals, it needs a long-term strategy that details actions to be taken to address this concern.

PREPARED STATEMENT OF BARRY JOHNSON, ACTING CHIEF, RESEARCH AND ANALYTICS, INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY; AND DOUGLAS O'DONNELL, DEPUTY COMMISSIONER, SERVICES AND ENFORCEMENT, INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY

Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee, thank you for the opportunity to discuss the tax gap.

Understanding the tax gap and its components helps government make better decisions about tax policy and the allocation of resources to tax administration. The IRS continues to pursue many different angles to address the tax gap. We are committed to enhancing taxpayer services and guidance, reducing noncompliance while ensuring fairness in the tax system and minimizing taxpayer burden.

MEASURING THE TAX GAP

The tax gap is defined as the difference between the amount of tax owed by taxpayers for a given year and the amount that is actually paid voluntarily and timely. The tax gap represents, in dollar terms, the annual amount of noncompliance with our tax laws.

Tax Gap Methodology and Data

The tax gap is determined by the IRS Research, Applied Analytics and Statistics (RAAS) organization. The most recent tax gap study released in 2019 covered Tax Years (TY) 2011–2013 (generally returns filed during calendar years 2012–2014). For that time period, the estimated gross tax gap (the amount of "true" tax that is not paid voluntarily and timely) was $441 billion.

The net tax gap is the amount of tax that will not be paid after subtracting from the gross tax gap the portion that eventually will be collected as a result of IRS enforcement activities or paid late but voluntarily by taxpayers. RAAS estimated that $60 billion of the gross tax gap eventually would be paid—either voluntarily or collected through IRS administrative and enforcement activities—resulting in an annual net tax gap of $381 billion of taxes owed as compared to what is actually paid. Without action to address this gap, the potential growth in the amount of taxes left unpaid and uncollected could result in a tax gap totaling several trillion dollars over the next decade.

When looked at by mode of compliance, the tax gap can generally be divided into three components:

- Nonfiling, or not filing required returns on time;
- Underreporting, or not reporting one's full tax liability when the return is filed on time; and
- Underpayment, or not paying by the due date the full amount of tax reported on a timely filed return.

Looking at the components of the tax gap, the non-filing gross tax gap was estimated at $39 billion, the underreporting gross tax gap was $352 billion and the underpayment gross tax gap was $50 billion. And by the various types of taxes, the estimated gross tax gap for individual income tax was estimated at $314 billion, the gross tax gap for corporate income tax was $42 billion, the gross tax gap for employment tax was $81 billion, and the gross tax gap for estate and excise tax combined was $3 billion.

The underpayment gap is the easiest component to measure because it is calculated directly from IRS administrative records for the individual income tax, the corporate income tax, employment taxes, estate tax, and excise taxes. Taxpayers who have filed returns indicating taxes owed but who have not paid the full amounts on time are identified upon filing. The difference between taxes owed as reported on returns and the amounts paid on time is the underpayment gap.

The other two components of the tax gap—nonfiling and underreporting—present vastly greater estimation challenges because they measure activity that is either not revealed to the IRS at all (such as failure to file a return) or may be reported in an understated fashion.

The predominant method used to calculate the underreporting gap involves actual audit data. For the individual income tax, this involves audits of a stratified random statistical sample of tax returns. These audits are time consuming, but they constitute a viable method for estimating the underreporting gap for the individual income tax. These audits are done under a program called the National Research Program (NRP) that has been in place since 2000. The audits are potentially broader in scope than the typical compliance/risk-based audits, in that they examine a set of issues that are determined by the NRP procedures instead of focusing on the top few compliance issues with a given tax return. The information gleaned from these audits helps us refine our audit selection tools, helping to ensure that our examiners are working the best possible cases under our risk-based models. This work also offers other more detailed insights about compliant and noncompliant behavior. Those insights are used throughout the IRS to focus our taxpayer service and enforcement work.

One of the key findings from our ongoing research on the tax gap has been that tax compliance is far higher when reported amounts are subject to information reporting and, more so, when subject to withholding as well. In our report on tax years 2011–2013, the net misreporting percentage (NMP) was calculated by looking at the net amount that was misreported (which includes both under- and over-reporting items) and expressing it as a ratio of the absolute value of the correct amount that should have been reported. This ratio was 1 percent for amounts subject to substantial information reporting and withholding, and 5 percent for amounts subject to substantial information reporting without withholding. But the NMP jumped to 55 percent for amounts subject to small amounts of or no information reporting or withholding.

In terms of what makes up the tax gap, the detected underreporting of business income by individual taxpayers—income of sole proprietors and those earning rental, royalty, partnership, and S corporation income—is the largest contributor, accounting for $110 billion of the total $441 billion in the 2011–2013 period. The IRS believes that the lack of reliable and comprehensive reporting and withholding for business income received by individuals is the main reason for these findings.

These statistics provide further confirmation that "visibility" of income sources and financial transactions is a significant contributor to increasing the compliance rates, and enhanced information reporting is one of the few means of sizably increasing the compliance rate. Business income reported on Form 1040s is a much lower-visibility income source because it is not often subject to the same information reporting and withholding requirements that exist for salary and wage income.

Over the years, our studies have consistently suggested that overall tax compliance is holding steady in the 82 percent to 84 percent range (the actual dollars represented by the tax gap can be impacted by whether the country is experiencing a recessionary economy but the percentage has remained mostly steady since about 2001). For TY 2011–2013, the estimated tax gap translated into about 83.6 percent of taxes paid voluntarily and on time, which is in line with recent levels. This estimate is essentially unchanged from a *revised* TY 2008–2010 estimate of 83.8 percent. After enforcement efforts are taken into account, the estimated share of taxes eventually paid is 85.8 percent for both periods and is in line with the estimates for TY 2001 and TY 2006 of 86.3 percent and 85.5 percent, respectively.

The IRS is in the process of preparing a new study on the tax gap, covering tax years 2014–2016 and we expect to release the updated report next year. It is important to note that the data needed to produce tax gap estimates using our traditional methodology takes a few years to collect, due to a number of factors. For example, taxpayers have until late in a given year to file a previous year's tax returns, and it then takes a few years to measure compliance. The IRS uses examination data to estimate some components of the tax gap, and that takes the longest amount of time to collect. Furthermore, reliable estimates require resource-intensive, time-consuming research gathered from a wide range of sources, including statistically selected in-person audits of taxpayers. The audit findings are supplemented by other information sources, such as income and expenditure information from third-party sources, information from late-filed returns, and tabulations from IRS Master Files of enforced and other collections. These steps mean that tax gap estimates traditionally trail the tax year as we gather data about compliance upon which to base the estimates. Current efforts to produce more timely estimates are detailed below.

Modernizing IRS Tax Gap Estimates

While the IRS's tax gap estimation methodology has been deemed a gold standard by other tax administrators because it is grounded in classical statistical methods, there is room for improvement. Technology and data collection and analysis are continuing to improve. In 2020, the Office of the Chief Statistician's Federal Committee on Statistical Methodology released a Framework for Data Quality, which builds on the Information Quality Act and advances the Federal Data Strategy. Timeliness, defined as the length of time between the event or phenomenon the data describe and their availability, was added as a key component of data quality. Likewise, as part of the IRS's ongoing efforts to improve tax gap estimation, the IRS is researching methods to reduce the lag between the focus tax years and release of the tax gap estimates by incorporating newer estimation methods that have emerged from the big data revolution.

This new methodology will make greater use of information collected during operational audits to augment a smaller, focused random statistical sample. By applying modern machine learning techniques to our data in close to real time, we hope to produce more timely estimates and projections of the tax gap that will better support strategic planning. These analyses will be grounded in data reported on tax returns and informed by contemporaneous audit results. In our preliminary research, applying this methodology to the 2011–2013 official estimate of the gross tax gap,

$441 billion, suggests the gross tax gap for 2019 would be approximately $600 billion.

Making greater use of the full range of filing and audit data collected by the IRS and evolving technology, we also hope to ensure that future tax gap measures better capture emerging issues. For example, data that underlie the tax year 2011–2013 estimates largely omit the platform economy and cryptocurrency because both were just beginning to gain popularity at that time. Today, these contribute significantly to the U.S. economy. Some estimates suggest that today the global cryptocurrency market may be as high as $2 trillion, suggesting the potential non-compliance from transactions involving this asset may be significant. Later this year, IRS will release statistics on the number of individual income taxpayers who reported holding cryptocurrency in their portfolio, and through collaborations between IRS researchers, field agents, and Criminal Investigation teams, we eventually hope to be able to estimate the contribution of this asset to the tax gap.

Making greater use of operational audit data, combined with advanced analytics will also provide insights into issues that are not well measured through statistical samples because they are highly concentrated in relatively small segments of the tax filing population. A recently released National Bureau for Economic Research (NBER) working paper, "Tax Evasion at the Top of the Income Distribution: Theory and Evidence," demonstrates the utility of the operational audit data for this purpose. By combining data from randomly selected audit cases and operational audits, the research team was able to measure sophisticated tax evasion by taxpayers at the very top of the income distribution that is not fully captured by our legacy tax gap estimation methodology. Based on the findings from that paper, IRS researchers estimated that though the use of offshore bank accounts and/or complex pass-through business structures, this evasion contributed an additional $33 billion to the 2011–2013 tax gap, which would amount to about $46 billion for Tax Year 2019. While this work is still undergoing peer review, the results seem very plausible.

Combining historically representative audit data, operational audit data, and data selected through a focused set of artificial intelligence workstreams with economic and budget projection data will allow us to estimate changes in the tax gap under different economic and budget scenarios. Incorporating enforcement resource data into this modeling and analysis will further aid us in developing strategies to change compliance behavior in response to emerging issues. This approach will also facilitate better tracking of IRS performance against strategic objectives, highlighting the role of IRS service and enforcement in promoting voluntary compliance.

In summary, by more fully leveraging IRS data collected during audits and applying cutting-edge analytic methods, we believe that we will be able to improve both the timeliness and coverage of the tax gap estimates so that these statistics will be more useful in helping shape IRS service and enforcement strategies. Our analysis so far shows that this approach can help us better detect and measure both emerging issues and issues that are concentrated in small segments of the population. It remains to be seen whether or not this approach will also help us do a better job of measuring other, difficult to detect issues, such as the cash economy and even illegal source income, both of which likely contribute significantly to the tax gap but by their nature, are largely missing from our current measures.

Making Better Use of Analytics at the IRS

Our progress in improving measures of the tax gap is just one of the many ways the IRS is using data, analytics, and cutting-edge technology to modernize tax administration. The machine learning-based approach described above is part of a broader strategy to develop new models for risk identification and workload selection to reduce the underreporting gap. The goal is to improve our ability to better identify returns with the highest probabilities of non-compliance and to prioritize those returns to ensure teams of highly specialized, highly trained examiners work those with the largest potential unreported tax liability first. As noted, one of the benefits of this approach is that by regularly updating the models using the most recent audit findings, we will incorporate emerging areas of risk into selection models.

The IRS is also incorporating behavioral insights in many aspects of our work, including pilots to inform improvements to IRS notices and outreach activities. We have employed plain language and other enhancements to certain notices alerting taxpayers to underpayment of taxes or delinquencies. We have also added QR codes to allow taxpayers who prefer using online tools to easily access a web page that allows them to make online payments or set up a payment plan. The early results of these activities suggest that taxpayers resolve issues earlier, reducing the need to send follow-up notices without increasing phone calls, which help to reduce the underpayment gap.

We are utilizing data and analytics to assist IRS employees by automating formerly time-consuming processes. This includes incorporating supervised robotic process automations that can quickly execute queries across multiple systems and compile them for human review and analysis, greatly reducing the time employees formerly spent on the same activities. Similarly, we are increasing our use of graphical databases that can be used to review clusters of activities or to provide a holistic view of all tax returns and information documents related to a specific entity, such as a business, tax-exempt entity or individual. For example, it can help an auditor see and drill down into all returns filed by partnerships in a complex business structure. This approach is also helping uncover sophisticated identity theft schemes, protecting millions of dollars in revenue from being paid in fraudulent refund claims.

ADDRESSING THE TAX GAP

Tax Gap Enforcement Efforts

The IRS uses the tax gap data to help decide where to deploy our resources, both to minimize burden on compliant taxpayers (*e.g.,* we would rather not audit someone who paid fully and timely) and to concentrate on reaching noncompliant taxpayers. Thanks to the help of artificial intelligence, advanced data, and analytic strategies, we have enhanced our capabilities to identify areas of noncompliance in ways that were not remotely possible just a few years ago. With that said, there is room to further modernize these efforts.

Yet, we cannot devote all of our resources to just the deepest pockets of noncompliance but also must ensure that tax enforcement has an indirect “deterrence” effect on taxpayers generally.

Enforcement supports the efforts of compliant taxpayers. To do this, we are exercising our best efforts with limited numbers of experienced, specialized examination personnel covering taxpayer compliance from several angles. Since 2018, we have shifted significant examination resources and technology to increase our focus on high-income/high-wealth taxpayers. We have also initiated a Compliance Initiative Project to ensure that we continue to maintain a high rate of audit coverage of taxpayers at the highest income categories using examiners across each of our operating divisions. Our specialized, most highly trained examination personnel are conducting audits of high-income/high-wealth taxpayers at an examination rate far higher than any other category of individual filers.

Investing in the agency that interacts with more Americans than almost any other public or private organization and collects almost 96 percent of the gross revenue of the United States of America is important. We must invest in meaningful taxpayer services, technology, data and analytics to improve the effectiveness of our existing enforcement workforce and programs, restore base enforcement functions that have declined substantially over the last decade, tackle key compliance priorities and emerging issues, and invest in programs that are essential to maintaining the broad compliance framework even though they may not directly generate revenue.

Funding and Enforcement Trends

The Congressional Budget Office (CBO) reported in “Trends in the Internal Revenue Service’s Funding and Enforcement” in July 2020 that IRS appropriations have fallen by 20 percent in inflation-adjusted dollars between 2010 and 2018, resulting in a decline of 22 percent in the number of IRS staff. Because labor costs account for about 70 percent of the IRS’s budget, measures to reduce the IRS workforce were instituted, including a hiring freeze from 2011–2018. The amount of funding and staff allocated to enforcement activities has declined by about 30 percent since 2010. In this regard, the CBO determined that experienced Revenue Agents, who handle complex enforcement examinations, fell by 35 percent and Revenue Officers, who manage difficult collection matters, dropped by 48 percent. According to the CBO, the number of examinations since FY 2010 dropped by about 40 percent even as the number of returns filed grew by 5 percent. The disruptions stemming from the 2020 coronavirus pandemic have further reduced the ability of the IRS to enforce tax laws.

The loss of more than 17,000 enforcement employees since FY 2010 led to a significant reduction in the number of examinations and the number of follow-ups on discrepancies between returns and third-party data, as well as an increase in assessments that were not collected and unfiled returns that were not secured. Enhancements in IRS technology are clearly helpful in offsetting some portion of the declining enforcement workforce, but we must acknowledge that such enhancements are hard pressed to significantly offset the increased sophistication of taxpayers and their transactions operating in a digital world economy coupled with the overall complexity of tax law.

As noted later in this testimony, the President has made a series of proposals as part of the American Families Plan to invest in the IRS and improve tax administration—including funding for increased enforcement activities—that will generate an additional $700 billion in tax revenue over the course of a decade, net of the investments made. This is important, because the IRS's enforcement activities also have an indirect, deterrent effect on the tax gap by discouraging taxpayers from making misstatements on their returns.

Foreign Account Tax Compliance Act (FATCA) Compliance Efforts

Congress enacted the Foreign Account Tax Compliance Act (FATCA) in 2010 to improve tax reporting compliance of U.S. Account Holders with assets held in Foreign Financial Institutions (FFI). Account Holders are required to annually report specified assets to the IRS on Form 8938, Statement of Specified Foreign Financial Assets, while FFIs are required to annually report to the IRS the specified assets of United States Account Holders on Form 8966, FATCA Report.

The IRS continues to perform outreach to ensure U.S. Account Holders and FFIs are aware of and able to timely and accurately report specified assets held abroad. Indeed, we coordinate with treaty partners and financial institutions to provide updated information which they may translate for improved use by those who are not proficient in English.

In addition to our ongoing outreach efforts, we have undertaken multiple efforts to improve compliance of United States Account Holders and FFIs to include the following:

- The IRS uses a variety of treatment streams such as soft letters, examinations and termination of an FFI's FATCA status.
- Examination, Collection, the Office of Fraud Enforcement (OFE) and Criminal Investigation (CI) use the information to either identify noncompliant taxpayers and FFIs or to assist with developing specific cases. For example:
    - CI has referred cases for examination based on FATCA data.
    - Examination, Collection, the OFE and CI are working to identify more instances of non-reporting of offshore accounts.
    - Collection utilizes FATCA data on balance due accounts to identify assets for collection as well as to identify certain non-filer/delinquent return cases of high-income non-filers.
- The IRS has a campaign to compare the filings by FFIs and individuals (*i.e.,* Form 8966, FATCA Report, and Form 8938, Statement of Specified Foreign Financial Assets). We began with soft letters to remind them of the need to timely and accurately report their assets and have examined others who have not.
- The IRS also has a campaign that compares the filings of FFIs and individuals for withholding compliance purposes.
- We conduct compliance checks of FFI certifications and send follow-up letters enabling FFIs to bring themselves into compliance. For those FFIs who will not comply, we will terminate them resulting in 30 percent withholding on certain United States Source Income. The IRS has terminated the FATCA status for nearly 1,000 non-compliant FFIs.
- FATCA data is associated with individual examination cases involving identified offshore-related issues, and third-party FATCA information received is also reconciled in numerous compliance activities on an ad hoc basis.
- The substantial increase in Foreign Bank Account Reporting (FBAR) filings, as well as the voluminous Form 8938 filings, both of which reflect the increased disclosure of individuals' foreign financial account holdings, demonstrate the significant voluntary compliance impacts of the FATCA regime. Indeed, the number of accounts reported on Forms 8938, Statement of Specified Foreign Financial Assets filed has grown from ~1.3 Million in 2014 to ~2.0 Million in 2019; FBAR reporting has grown from ~538,000 in 2010 to ~1.4 Million in 2019, and; the number of Form 8966, FATCA Report has grown from ~1.6 Million in 2014 to ~6.3 Million in 2019.

While the IRS has significantly increased its compliance efforts in recent years, we continue to be limited by technological and staffing limitations. Improved systems and data analytics capabilities, as well as more data scientists, analysts and enforcement personnel would improve our ability to better assist those United States Account Holders and FFIs who want to comply and improve fairness to all by taking appropriate enforcement actions on those who do not want to or will not comply.

The American Families Plan

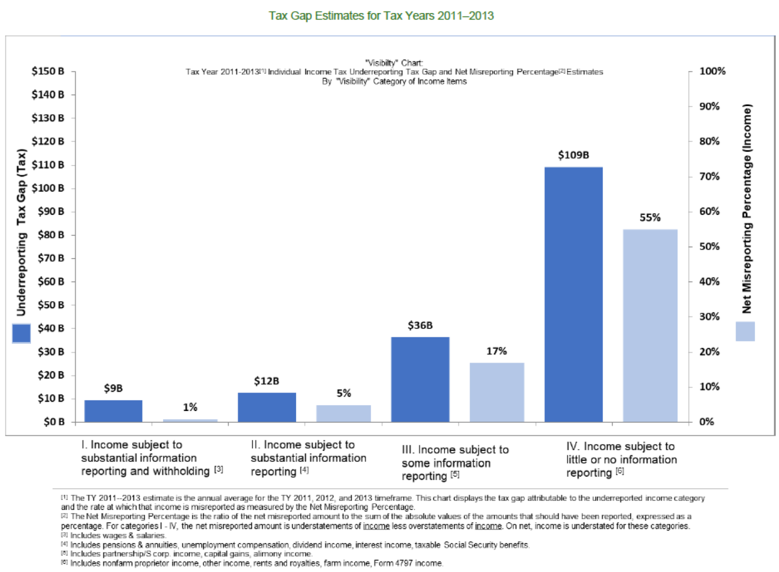
A robust and sustained investment in the IRS is necessary to ensure it can do its job of administering a fair and effective tax system. In the American Families Plan, the President has included a series of proposals that overhaul tax administration and provide the IRS the resources and information it needs to address tax evasion. All told, these reforms will generate an additional $700 billion in tax revenue over the course of a decade. Specifically, the tax administration reforms will:

- *Provide the IRS the resources it needs to stop sophisticated tax evasion.* The IRS needs resources to pursue costly tax evasion. These cases are not easy to resolve; the average investigation of a high-wealth individual takes 2 years to complete and often requires the IRS to commit substantial resources. Moreover, the lack of investment in compliance has significant revenue consequences. Altogether, the proposal would provide roughly $80 billion to the IRS over a decade to fund an array of priorities—including overhauling technology to improve enforcement efforts. This investment will also facilitate the IRS hiring and training auditors to focus on complex investigations of large corporations, partnerships, and global high-wealth individuals. The President's proposal would ensure that additional resources go toward enforcement against those with the highest incomes, rather than Americans with actual income of less than $400,000.
- *Provide the IRS with more complete information.* When the IRS has information from third parties, income is accurately reported, and taxes are fully paid. However, high-income taxpayers disproportionately accrue income in opaque sources—like partnership and proprietorship income— where the IRS struggles to verify tax filings. This proposal would provide the IRS information on account flows so that it has a lens into investment and business activity—similar to the information provided on income streams such as wage, pension, and unemployment income. Importantly, this proposal provides additional information to the IRS without any increased burden for taxpayers. Instead, it leverages the information that financial institutions already know about account holders, simply requiring that they add to their regular, annual reports information about aggregate account outflows and inflows. Providing the IRS this information will help improve audit selection so it can better target its enforcement activity on the most suspect evaders, avoiding unnecessary (and costly) audits of ordinary taxpayers.
- *Overhaul outdated technology to help the IRS identify tax evasion.* Elements of IRS IT systems are antiquated and make it difficult for the IRS to identify those who are not paying what they owe and to help those who want to comply. The President's proposal provides the IRS much-needed resources to modernize its technological infrastructure. Leveraging 21st-century data analytic tools will enable the IRS to make use of new information about income that accrues to high-earners and will help revenue agents unpack complex structures, like partnerships, where income is not easily traced.
- *Improve taxpayer service and deliver tax credits.* A well-functioning tax system requires that taxpayers be able to interact with the IRS in an efficient and meaningful manner. Inadequate resources often mean that IRS employees are unable to provide taxpayers timely answers to their tax questions. Service enhancement will improve the ability of the IRS to communicate with taxpayers securely and promptly. Importantly, the proposal also includes the necessary resources to ensure that the IRS effectively and efficiently delivers tax credits to families and workers, including the administration's proposal to make the Child Tax Credit and the advance payments permanent.
- *Regulate paid tax preparers.* Taxpayers often make use of unregulated tax preparers who lack the ability to provide accurate tax assistance. These preparers submit more tax returns than all other preparers combined, and they make costly mistakes that subject their customers to painful audits, sometimes even intentionally defrauding taxpayers for their own benefit. The President's plan calls for giving the IRS the legal authority to implement safeguards in the tax preparation industry. It also includes stiffer penalties for unscrupulous preparers who fail to identify themselves on tax returns and defraud taxpayers (so-called "ghost preparers").

Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee, thank you again for the opportunity to discuss the tax gap. This concludes the IRS's statement.

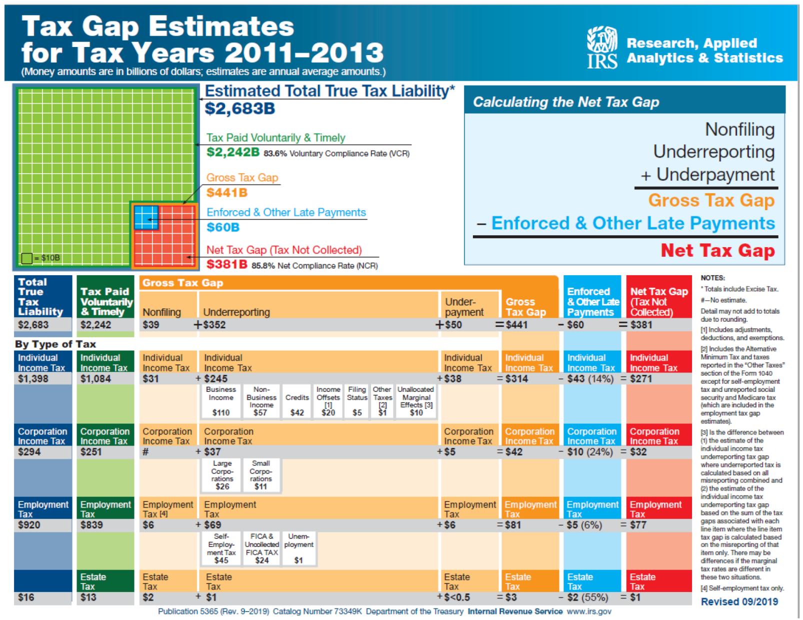
APPENDIX 1: TAX GAP VISIBILITY

Source: Page 14, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013, Publication 1415 (Rev. 9–2019) Catalog Number 10263H Department of the Treasury, Internal Revenue Service



APPENDIX 2: TAX GAP MAP

Source: Page 8, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013, Publication 1415 (Rev. 9–2019) Catalog Number 10263H Department of the Treasury, Internal Revenue Service



QUESTIONS SUBMITTED FOR THE RECORD TO BARRY JOHNSON

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. What is the IRS's latest official estimate of the tax gap?

Answer. The current gross tax gap estimate, based on TY11–TY13, is $441 billion. The next set of tax gap estimates, based on TY14–TY16, will be released in spring 2022 and will include projections of tax gap for TY17–TY19.

Question. How does the voluntary tax compliance rate of the United States compare to other countries, namely countries from the OECD?

Answer. Because the tax regimes of OECD countries vary widely, they are not easily comparable. For example, many of the OECD countries include a value-added tax (VAT) as part of their tax regime, while the United States does not. In the UK payments for both National Insurance and VAT are included in their tax gap estimates. In their 2020 release, HM Revenue and Customs reports an estimated gap of 4.7 percent, that is analogous to the net tax gap reported in the IRS tax gap report (computed as the gross tax gap less enforced and other late payments). This equates to a net compliance rate of 95.3 percent as compared to the net compliance rate of 85.8 percent reported by IRS in the "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013." The UK does not include a measure of the voluntary compliance rate in their report.

Question. What data does the IRS have as to whether, or how much, self-prepared tax returns contribute to the tax gap?

Answer. The IRS does not have a separate breakout of how much self-prepared tax returns contribute to the tax gap. The tax gap is a high-level measure that breaks out type of tax (individual, corporate, excise, and estate) by whether the gap relates to nonfiling, underreporting, or underpayment.

QUESTIONS SUBMITTED FOR THE RECORD TO DOUGLAS O'DONNELL

QUESTIONS SUBMITTED BY HON. SHELDON WHITEHOUSE

Question. In 2010, Congress passed the Foreign Account Tax Compliance Act (FATCA), with bipartisan support, to provide the IRS the information it needs to find hidden income in offshore accounts. Inspector General George noted in his testimony that as of 2018—nearly a decade after the law's passage—"the IRS had taken virtually no compliance actions to meaningfully enforce the Foreign Account Tax Compliance Act (FATCA)."

How have resource constraints and outdated technology impacted your ability to make effective use of the information the IRS collects?

Answer. The IRS's ability to conduct data analysis of, as well as comparisons between, Forms 8938 filed by U.S. account holders and Forms 8966 (or FATCA reports) filed by or on behalf of foreign financial institutions (FFIs) has been impacted by the following factors:

- Both information technology and human resource limitations have caused delays in the time it takes to make FATCA data available for analysis and use. Moreover, taken together, the constraints set forth below have precluded the development of fully automated data matching capabilities.
- IRS information technology limitations have made it difficult to conduct queries and analysis of data relevant to FATCA enforcement. By way of example, development of new capabilities for the primary database intended to house data from Forms 8938 and 8966 was halted in 2018 due to budget and resource constraints prior to deployment of functionality that would have made it easier to query, extract, and analyze FATCA data. An interim reporting solution has produced more limited and less usable output. More effectual utilization of FATCA data currently requires highly specialized and trained IRS employees who must develop complex code.
- Forms 8938 and 8966 apply divergent reporting conventions, foreign currency conversion standards, and exceptions and alternatives to reporting that significantly complicate analysis and use of FATCA data and preclude straightforward form-to-form matching as a means to identify non-compliance. These data do not lend themselves to the automated matching models of the Automated Under Reporter system, but rather require resource-intensive review and comparison of the data. Moreover, current law (including intergovernmental agreements with other countries that provide FATCA information to the United States) does not require that FFIs report their Global Intermediary Identification Numbers (GIINs) to their U.S. account holders, and similarly current regulations do not require U.S. account holders to report the GIINs of the FFIs with whom they maintain reportable accounts on their Form 8938 filings because of concerns that it might be difficult for individuals to obtain GIINs without such reporting from FFIs. Similarly, guidance has allowed for the deferral of taxpayer identification number (TIN) reporting by FFIs on Forms 8966 in many instances through the 2019 tax year. The absence of these reporting requirements significantly increases the resource load on the IRS, both in terms of information technology and employees, in making optimal and timely use of data relevant to FATCA enforcement.

Further, after the data are available for use, resource constraints in our compliance functions have impacted the magnitude of compliance activities we are able to conduct regarding both the individual and financial institution populations.

Question. What can the IRS do to improve the accuracy of data provided by foreign banks? What tools does IRS have to encourage or compel compliance?

Answer. The IRS has and will continue to provide educational and outreach efforts, conduct compliance checks of FFIs, and terminate GIINs of non-compliant FFIs both to improve the accuracy of data provided and to encourage and compel compliance. The termination of the GIIN would result in thirty percent tax for any FATCA withholdable payment of U.S. source income being paid to the FFI, pursuant to the FATCA rules.

Question. When does the IRS plan to crack down on those with offshore bank accounts who fail to file FATCA disclosure forms?

Answer. The IRS has been and continues to utilize FATCA data in its compliance activities. LB&I has a campaign filter approved for compliance efforts (including soft letters and examinations) that identifies individuals with offshore bank accounts who may have erroneously failed to file FATCA disclosure forms. This filter is currently being run on the 2019 tax year data, due to our expectation of greater TIN reporting rates in later years. Without TIN reporting, it is much more difficult to verify the taxpayer, and when addressing potential non-filers, the IRS must be certain it has identified the correct (non-reporting) taxpayer.

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. What is the IRS doing to improve how the agency estimates the tax gap so that members and the public can get a number that is more timely and accurate?

Answer. The next tax gap estimate will be released in the spring of 2022. In addition to the formal estimates for the TY14–TY16 time frame, the report will include projections for TY17–TY19. At the time the next tax gap report is issued, TY19 will be the most current year with all or nearly all returns filed.

The existing tax gap methodology is sound and conforms with OMB requirements for producing reliable official statistics in that the methodology is rigorous, peer-reviewed, and based on well-established statistical principles. Since our objective with tax gap estimation is to measure compliance behavior as that behavior is manifested in tax not paid voluntarily and timely, we strive to base our estimates on observed compliance for the years being estimated. There is, therefore, a tradeoff between achieving that and the contemporaneousness of the estimates, especially in the context of the underreporting tax gap estimates, which are based on examination data. The addition of projections in the next release will address some of the timing concerns. Those projections eventually will be revised once additional compliance data for those years becomes available.

We continually review our estimation methodologies to identify refinements and additional data that would improve the estimates. We also conduct separate studies to understand emerging issues such as trends in international noncompliance or changes to the economy (*e.g.,* the emergence of the gig economy) to understand their impact on tax administration.

Question. As the IRS is currently in the process of preparing a new study on the tax gap, how will the study focus on ways to better understand the contributing factors that allow for errors and omissions on tax returns that are completed by type of tax (for example, individual income tax, corporation income tax, employment tax, and estate tax)?

Answer. Outside of the framework of the tax gap, the IRS has a robust program of research into specific compliance areas including extensive behavioral research intended to produce more effective notices and nudges designed to improve voluntary compliance. The research includes studies to specifically understand contributing factors that allow for errors and omissions on tax returns. These reports are much more granular in detail and allow for better identification of root causes.

For example, the IRS has conducted separate studies of the sources of errors for the Earned Income Tax Credit, the Child Tax Credit, and the education credits. The IRS also completed an analysis of employer compliance with Form 1099 Miscellaneous Income (Form 1099–MISC), one specific issue in the employment tax compliance area. The challenge with all analyses of compliance is the need for data that can be used to develop reliable estimates of the population. The type of data that is essential for understanding the nature and extent of noncompliance often differs from the type of data that is needed for basic tax administration and therefore requires additional resources to collect. Data availability limits the type of detail that is available, especially for corporation income tax and estate tax.

Question. What recommendations, if any, does the IRS's research division have to develop more timely and accurate estimates of the tax gap?

Answer. As mentioned in the response above, the next tax gap estimates will include projections through TY19, which will be the most current year with full or nearly full timely return filings. Currently, the compliance-related data available for tax gap estimation support methodologies that yield reliable estimates by broad categories of tax and sources of noncompliance (nonfiling, underreporting, and underpayment)—and for individual income tax, for selected tax return and schedule line items. Additional data collection geared to specific objectives and/or areas of interest would be of benefit because it would allow reliable estimation at a more disaggregated level and could help quantify potential compliance problems associated with new and emerging issues (*e.g.,* the comprehensiveness of third-party reporting related to cryptocurrency transactions.) We have been working on updating and enhancing the underlying methodology, making more current estimates, and considering how to identify and incorporate additional information and emerging compliance issues. By including more operational audit data, RAAS anticipates we'll be able to produce estimates that are more timely and inclusive and include forecasts of emerging issues.

Question. According to official IRS data and research, overall tax compliance rates have been holding steady around 85 percent since the 1980s (voluntary tax compliance around 82–84 percent and net tax compliance around 85–86 percent with late payments and enforcement). That is a relatively high and stable compliance rate for at least 40 years. GAO has recommended a long-term, quantitative goal for improving taxpayer compliance (ex. 85 percent, 86 percent, 87 percent, etc.).

How does the IRS view GAO's proposal of a clear numerical target in terms of addressing progress related to the tax gap?

Answer. The gross tax gap and voluntary compliance rate (VCR) appear to be appealing measures because they synthesize noncompliance behavior (as manifested in tax voluntarily and timely paid) into single numbers. However, the tax gap measures do not have properties that are well suited for purposes of setting goals and targets for the IRS. IRS actions alone do not determine the level of voluntary compliance and the measure is much more likely to change resulting from macroeconomic factors or legislative changes than discrete actions taken by the IRS.

The IRS has established and reports on a series of measures as part of its strategic plan. Additionally, the IRS routinely conducts studies outside the framework of the tax gap estimates that report on compliance efforts related to specific programs and issues. These studies provide more detailed analyses and assessments of specific programs or issues and provide evidence on how procedural and other changes can enhance compliance and/or improve the efficiency of IRS activities.

PREPARED STATEMENT OF NINA E. OLSON, EXECUTIVE DIRECTOR, CENTER FOR TAXPAYER RIGHTS

Chairman Whitehouse, Ranking Member Thune, and members of the subcommittee, thank you for inviting me to appear before you today at this hearing to discuss the important issue of the Federal tax gap and lost revenue attributable to noncompliance and offshore tax evasion. It feels like I have spent my entire professional career wrestling with taxpayer compliance, taxpayer rights, and the tax gap, first as an unenrolled return preparer helping individuals and small businesses comply with the tax laws, next as a tax controversy attorney representing low-income taxpayers and others before the IRS and in the courts, then for 18 years as the National Taxpayer Advocate, and today, as the executive director of the Center for Taxpayer Rights,[1] where our focus is awareness and protection of taxpayer rights in the United States and internationally.

As National Taxpayer Advocate, I regularly made the case for increased IRS funding in order to maintain and improve tax compliance, not just for additional hiring of audit and collection employees but also those in the taxpayer service functions, the Office of Appeals, and the Taxpayer Advocate Service (TAS). I first identified the Cash Economy Tax Gap as a Most Serious Problem of taxpayers in my 2003 Annual Report to Congress, and recommended withholding on non-wage workers in that report.[2] I identified the tax gap as a Most Serious Problem or made legislative recommendations to address it in at least three other Annual Reports.[3] As early as 2006, I submitted a legislative recommendation for revising Congressional Budget

[1] The Center for Taxpayer Rights is a 501(c)(3) corporation that promotes taxpayer rights in the United States and internationally. For more information about the Center, *see https://www.taxpayer-rights.org/*.

[2] National Taxpayer Advocate 2003 Annual Report to Congress, Most Serious Problem: *Nonfiling and Underreporting by Self-Employed Taxpayers,* 20–25; and Legislative Recommendation: *Tax Withholding on Nonwage Workers,* 256–269.

[3] National Taxpayer Advocate 2004 Annual Report to Congress, Legislative Recommendation: *Tax Gap Recommendations,* 478–489; National Taxpayer Advocate 2005 Annual Report to Congress, Most Serious Problem: *The Cash Economy,* 55–75; Legislative Recommendation, *Measures to Reduce Noncompliance in the Cash Economy,* 381–396; and National Taxpayer Advocate 2006 Annual Report to Congress, Most Serious Problem: *The Tax Gap,* 6–9.

Procedures both to increase IRS funding and accountability.[4] In my 2011 Annual Report to Congress, I identified IRS (under)funding as a Most Serious Problem, and raised that issue again in my 2012 and 2013 Annual Reports.[5] In 2018, I made a legislative recommendation to address sustained Information Technology (IT) multi-year funding.[6] All of these proposals are framed in the context of taxpayer rights and the fundamental principle that the government must treat the taxpayers on which it relies for its "lifeblood" with decency, respect, accuracy, and integrity.

Despite its funding challenges, the IRS has plugged on, and in many instances has performed admirably. Its issuance of three rounds of Economic Impact Payments is nothing short of miraculous. Notwithstanding this performance, in my testimony today I will describe the problems created by the current state of IRS resources, technology, and skillsets. I do this not to denigrate the IRS but to make the case that to address the tax gap we need transformational change, and that change must occur in the context of minimizing undue taxpayer burden and protecting taxpayer rights. That change also will require significant investment in new technology, leadership, employees, training, procurement skills, and funding. It requires a massive redesign of IRS systems, phased in over all IRS systems, so that they can process information and talk to one another in real time in order to keep up with current and trending issues. It requires upgrading the input systems—those that receive data and complete error processing, and it requires all systems to update quickly and be flexible. "Flexible" is not a word often applied to IRS systems today.

All of this is not going to happen overnight. And although this is a monumental undertaking, I want to emphasize that such change is possible. It will take a lot of work, in increments. It will take sustained funding, and sustained oversight. It will require additional hiring authorities, and it will require IRS leadership and personnel who are experienced and capable of overseeing and delivering a project of this magnitude. In my opinion, there really is no choice about all this—it must occur. If we do not make these investments in the IRS, we will not only *not* address the upper reaches of the tax gap, but we will actually risk *increasing* the tax gap by failing to meet the needs of taxpayers who are compliant or who are in good faith trying to comply with the law. That is a result we cannot allow to happen.

IN THE DRIVE TO "ENFORCE" THE TAX LAWS, WE CANNOT ALLOW THE EMPHASIS ON ENFORCEMENT TO COME AT THE EXPENSE OF TAXPAYER SERVICE

I first appeared before the Senate Finance Committee in February 1998, as the executive director of The Community Tax Law Project, the first independent low-income taxpayer clinic in the country.[7] I testified about how the Service's drive to collect taxes and its failure to consider the facts and circumstances of individual taxpayer's situations led to harmful overreach, especially for low income and middle class taxpayers who could not afford representation. The passage of the landmark Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)[8] was a watershed in the advancement of taxpayer rights, equaled only by the passage of the Taxpayer Bill of Rights in 2015,[9] and the Taxpayer First Act in 2019.[10]

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[4] National Taxpayer Advocate 2006 Annual Report to Congress, Legislative Recommendation: *Revising Congressional Budget Procedure to Improve the IRS Funding Decisions,* 442–457.

[5] National Taxpayer Advocate 2011 Annual Report to Congress, Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes,* 3–14; National Taxpayer Advocate 2012 Annual Report to Congress, Most Serious Problem: *The IRS is Significantly Underfunded to Serve Taxpayers and Collect Tax,* 34–41; and National Taxpayer Advocate 2013 Annual Report to Congress, Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance,* 20–39.

[6] National Taxpayer Advocate 2018 Annual Report to Congress, Legislative Recommendation: *IT Modernization: Provide the IRS With Additional Dedicated, Multiyear Funding to Replace Its Antiquated Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and Is Evaluated Annually by an Independent Third Party,* 351–358.

[7] *IRS Restructuring: Hearings on H.R. 2676 Before the Senate Committee on Finance,* 105th Congress 105–529, at 329–40 (1998) (statement of Nina E. Olson, executive director, The Community Tax Law Project).

[8] Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206, 112 Stat. 685.

[9] Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114–113, § 401, 129 Stat. 3040, 3117.

[10] Taxpayer First Act, Pub. L. No. 116–25, 133 Stat. 981.

Approximately 2 percent of the $3.6 trillion the IRS collects each year comes from direct enforcement actions.[11] The remaining 98 percent comes from the indirect effect of a mixture of people's fears about IRS enforcement and their desire to be compliant with the tax laws (tax morale). Even the compliance of purely wage-earning taxpayers, who are subject to reporting *and* withholding, is attributable to their employers voluntarily withholding and depositing payroll taxes. Because it is easier to measure the direct revenue effect of enforcement, however, budgets for administrations of both parties have consistently proposed increased enforcement spending, usually through the device of a program integrity cap, giving taxpayer service short shrift.[12]

The chronic underfunding of taxpayer service has led to an environment where we routinely see delays in mail handling and telephone "level of service" (LOS) performance at 50 to 60 percent, measured as the percentage of calls the IRS directs to a live assistor that actually reach a live assistor.[13] According to the National Taxpayer Advocate, the IRS LOS on the main 1040 number plummeted to 5 percent during the current filing season, and the TAS measure of LOS actually placed it at 2 percent.[14] This means 98 percent of calls to the main IRS number did not get through to a live assistor. For FY 2021, the IRS requested funding that would provide LOS at 60 percent, which Congress approved. This means we've accepted it is okay to *not answer 4 out of 10 calls* from taxpayers who the IRS directs to reach a live assistor at the IRS.[15]

Today, much of the IRS's compliance contacts fall in the category of what I call "unreal audits."[16] According to IRS chief counsel, they do not meet the definition of an audit, which involves an examination of the taxpayer's books and records (IRC § 7602). Yet for millions of taxpayers each year, these unreal audits sure feel like an audit, and they can result in an assessment of additional tax (and penalties) just like an audit, even if the IRS does not include these contacts in its calculation of audit rates. Take summary assessments under IRC § 6213(b), for example, also known as "math errors." Summary assessment authority (SAA) allows the IRS to make an immediate adjustment to a taxpayer's return and only follow deficiency procedures (including the right to petition Tax Court before paying the tax) if the taxpayer objects within 60 days. Yet the math error notices are incomprehensible. The typical math error notice (Notice CP–11) reads as follows:

Changes to your 2019 Form 1040

We found miscalculations on your 2019 Form 1040, which affect the following areas of your return:

- Income
- Tax Computation

We changed your return to correct these errors. As a result, you owe $xxxx.

Buried on page 3 of this 4-page notice is some language that is only marginally more helpful:

[11] IRS, 2019 Data Book, Table 1 and Table 25 (June 2020). The IRS collected a total of $3.56 trillion in FY 2019. It reported approximately $60.1 billion in revenue attributable to its collection activities, including $44 billion (net after credit transfers) on balance due returns, $1.89 billion on delinquent returns, $289 million on offers in compromise, and almost $14 billion on installment agreements.

[12] The National Taxpayer Advocate reports the IRS Taxpayer Service enacted appropriations provided for 28,531 full-time employees in FY 2019, 26,760 in FY 2020, and down to 25,678 for FY 2021. National Taxpayer Advocate 2020 Annual Report to Congress 32.

[13] *Id.* at 31.

[14] NTA Blog: 2021 *Filing Season Bumps in the Road: Part I* (April 22, 2021) at *https://www.taxpayeradvocate.irs.gov/news/nta-blog-2021-filing-season-bumps-in-the-road-part-1/.*

[15] *Id.* at 30. Of course, this LOS does not account for the calls the IRS phone tree directs away from a live assistor, even though the caller may want to talk to someone and not reach an automated line. In this way, the IRS performance measure misrepresents the taxpayer experience on the phones.

[16] *See* National Taxpayer Advocate 2017 Annual Report to Congress, Most Serious Problem: *Audit Rates: The IRS is Conducting Significant Types and Amounts of Compliance Activities That it Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections,* 49–63. *See also* NTA Blog: *"Real" vs. "Unreal" Audits and Why This Distinction Matters* (July 6, 2018) at *https://www.taxpayeradvocate.irs.gov/news/ntablog-real-vs-unreal-audits-and-why-this-distinction-matters/.*

Changes to your 2019 tax return

	Your Calculation	IRS Calculation
Adjusted Gross Income, Line 8b		
Taxable Income, Line 11b		
Total Tax, Line 16		

That's all the information a taxpayer gets about this "error" and change. This vague language, which fails to put the taxpayer on notice of precisely what was changed on a taxpayer's return so they can decide if the IRS is correct or not, contravenes Congress's explicit direction to the IRS when it expanded math error authority in 1976. At that time, Congress told the IRS it would get this expansion but to address fairness concerns about removing more situations from deficiency procedures, Congress added IRC § 6213(b)(1), which requires that "[e]ach notice under this paragraph shall set forth the error alleged and an explanation thereof." The House and Senate Committee Reports both directed the IRS to phrase the notice regarding inconsistent entries on returns in such a way as to include questions designed to show why the IRS had chosen to challenge a particular entry on the taxpayer's return.[17] It is now almost 50 years later, and IRS math error notices are as vague and imprecise as they were in 1976. This is a violation of the taxpayer's *right to be informed, to quality service, and to challenge the IRS and be heard.*[18]

Upon receipt of a summary assessment/math error notice, the taxpayer has 60 days to dispute the IRS's assessment in order to have the tax abated. In the taxpayer disputes it timely, the IRS will review the change and if the IRS believes the original assessment is correct, the IRS must issue a Notice of Deficiency, giving the taxpayer the opportunity to petition the U.S. Tax Court before having the pay the tax.

If the taxpayer calls the IRS to get clarification about the specific item that was changed pursuant to a SAA/math error notice so he can decide whether to dispute the notice, technology defeats him. IRS assistors on the phone number listed on the notice cannot see the taxpayer's return to know what caused the problem. That assistor must fill out the dreaded Form 4442 "referral" to another IRS function.[19] That function may or may not provide the taxpayer with a substantive answer, but it will generally send a letter saying it needs 30 days to review. And then the taxpayer will get another letter, saying it needs another 30 days to review. (This letter is referred to as a "stall letter" in IRS jargon.) By this time the taxpayer is in an anxiety-producing situation—60 days will soon elapse and the taxpayer doesn't know if the IRS has abated the assessment or if the taxpayer's account will proceed to collection.

Customer service representatives and other IRS employees have no access to a 360-degree view of the taxpayers account because the IRS has no database in which all taxpayer information is stored or linked. Although the IRS has been working on an Enterprise Case Management system since at least 2015, it still has 60 separate major databases containing taxpayer information. The lack of a full picture of the taxpayer's tax life has significant consequences not only for taxpayer assistance but also for audit selection, collection prioritization, and protection of taxpayer rights.

Dreams of the future IRS having purely digital communications with taxpayers will likely not materialize any time soon. Dealing with the IRS has consequences that don't accrue to a bad Amazon or airline transaction. For example, over the next 2 years, there will be millions of taxpayers with Paycheck Protection Program loans and Employee Retention Credits, hundreds of millions reconciling Rebate Recovery Credits for 2 years straight, millions claiming and reconciling a new Advance Child Tax Credit, and an influx of reporting on gig economy workers. If these taxpayers receive an IRS notice questioning their return, it is unlikely they will be comfortable with just going online to resolve the matter (if they make it through the IRS online

[17] *See* H.R. Rep. 94–658, at 289 and S. Rep. No. 94–938(I), 94th Cong., 2d Sess. 375 (1976). The reports cited an example where the taxpayer enters six dependency exemptions, but then calculates for seven exemptions; in this case, the IRS should phrase its notices to show the taxpayer the specific discrepancy and inform the taxpayer they might be eligible for the greater number of exemptions. For a detailed discussion of math error notices, *see* National Taxpayer Advocate 2014 Annual Report to Congress, Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making it Difficult for Taxpayers to Understand and Exercise Their Rights,* 163–171.

[18] I.R.C. § 7803(a)(3); IRS, Publication 1, *Your Rights as a Taxpayer* (Rev. September 2017).

[19] *See* IRM 21.3.5.

account authentication required to open an account), especially when their bank accounts could be levied, their refunds offset, and their wages levied, all without any judicial review. Taxpayers want to know that they have been listened to and they want answers. They have the *right to be informed, the right to quality service, the right to pay no more than the correct amount of tax, and the right to challenge the IRS and be heard.*[20] Taxpayer service, which is so important to achieving the level of compliance we have today, must be funded to maintain that level.

> *Recommendation:* Amend IRC § 6213(b)(1) to require any notice of assessment issued pursuant to the IRS's summary assessment authority under that section to include a reference to the specific form and line that has been adjusted as well as a detailed explanation of the adjustment, including the amount of adjustment and the reason therefor. Further, require that the notice prominently displays on its first page the last date for requesting abatement and explain on the first page the consequences of not requesting abatement before the last day listed. Finally, require the IRS to provide the taxpayer with a dedicated fax number or email address for making the request, and require the IRS to issue an acknowledgement letter or email, informing the taxpayer the request has been received and the tax is abated pending further review.[21]

THE TAX GAP DOES NOT EQUAL TAX EVASION

Recent studies estimating the amount of unreported income by the highest-income taxpayers, and proposals to reduce the underreporting component of the tax gap by increased information reporting, along with the Commissioner's guestimate that the annual tax gap could be as much as $1 trillion, have led policy-makers, commentators, and the media to equate the tax gap with tax evasion.[22] The ubiquitous usage of this phrase actually dilutes its meaning and impact. It also allows very different types of noncompliance attributable to very different causes to be lumped together. And framing noncompliance as tax evasion not only undermines compliance among the currently compliant, who will begin to feel naïve for complying, but it creates an environment in which tax agency personnel can feel justified in undermining if not outright ignoring taxpayer rights and protections.

I have always viewed tax noncompliance as a continuum of behavior and causes—*i.e.,* factors that influence that behavior.[23] Even as the financial, technology, and economic landscape evolves, not all noncompliance can be categorized as "tax evasion." Take cryptocurrency, for example. A wide variety of human beings use cryptocurrency for a wide variety of reasons. Not all of that usage is on the dark web—some people purchase it for novelty or for investment, some people use it for everyday transactions. An article about the recent Coinbase initial public offering on Nasdaq notes that one-third of small and medium-sized U.S. businesses accept cryptocurrency as payment.[24] Not everyone understands which cryptocurrency transactions constitute a realizable event for tax purposes, much less when that event generates taxable income. Indeed, the IRS only issued guidance on cybercurrency in 2014.[25] Yet the IRS has clearly adopted the viewpoint that mere *owner-*

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[20] I.R.C. § 7803(a)(3); IRS, Publication 1, *Your Rights as a Taxpayer* (Rev. September 2017).

[21] Regarding similar shortcomings of IRS notices providing taxpayers their right to a Collection Due Process hearing, see National Taxpayer Advocate 2018 Annual Report to Congress, Most Serious Problem: *Collection Due Process Notices: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review,* 212–222.

[22] *See, e.g., Washington Post,* "IRS chief says cheats are costing the U.S. $1 trillion a year," April 13, 2021 at *https://www.washingtonpost.com/business/economy/irs-chief-says-cheats-are-costing-the-us-1-trillion-a-year/2021/04/13/128f1b0c-9c5d-11eb-b7a8-014b14aeb9e4_story.html;* and *New York Times,* "Tax cheats cost the U.S. $1 trillion per year, IRS chief says," April 13, 2021, at *https://www.nytimes.com/2021/04/13/business/irs-tax-gap.html.*

[23] Professor Leslie Book described a typology of tax noncompliance, based on the work of sociologists Robert Kidder and Craig McEwen. *See* L. Book, "The Poor and Tax Compliance: One Size Does Not Fit All," in *Kansas Law Review,* vol. 51, 1145–1195 (2003). Kidder and McEwan identified eight types of tax noncompliance: procedural, "lazy" or characteristic, unknowing, asocial, brokered, symbolic, social and habitual.

[24] "'It's more than just Coinbase': Crypto Giant snares $85.8 billion valuation in Nasdaq debut," *Washington Post,* April 14, 2021 at *https://www.washingtonpost.com/business/2021/04/14/coinbase-ipo-crypto-bitcoin/?utm_source=rss&utm_medium=referral&utm_campaign=wp_business.*

[25] Internal Revenue Service, Notice 2014–21, at *https://www.irs.gov/pub/irs-drop/n-14-21.pdf.* In 2013 I identified the IRS Chief Counsel's failure to address the treatment of cryptocurrency as a Most Serious Problem of taxpayers. National Taxpayer Advocate 2013 Annual Re-

ship or acquisition of cybercurrency is an act worthy of closer scrutiny—in a prominent place on the 2020 Form 1040, Individual Income Tax Return, it asks *every taxpayer* the following question (under penalties of perjury): "At any time during 2020, did you receive, send, sell, exchange or otherwise acquire any financial interest in any virtual currency?" This question, on its face requiring the reporting of the acquisition of virtual currency, has brought almost universal condemnation as overreach.[26]

Leaving cryptocurrency aside, of the current $441 billion gross tax gap estimate by IRS,[27] some portion of the underreporting gap is attributable to errors made as a result of tax law complexity (unknowing noncompliance) and others are attributable to procedural complexity and barriers—for example, where taxpayers are eligible for a deduction or credit but cannot navigate the bureaucracy on their own and cannot afford representation, so they just give up (functional or characteristic noncompliance).

Then there is that component of the tax gap attributable to underpayment, which will most assuredly increase as a result of the pandemic economy. Are the taxpayers who failed to make tax payments during this period *tax evaders* and *tax cheats* because their businesses shut down or went under during this period, or because they lost their jobs? Maybe some actively engaged in evasion, but most faced extraordinary challenges making ends meet and simply weren't able to pay their taxes as well. Failure to differentiate between the causes of noncompliance results in the tax agency taking disproportionate actions and risks turning struggling noncompliant taxpayers into determined and intentional tax evaders. At a minimum, such a failure erodes trust, which is never good for a tax system and which research has shown is vital to achieving and maintaining voluntary tax compliance.

LESSONS FROM THE OVDP SETTLEMENT INITIATIVES

As the IRS continues to focus on the tax gap attributable to offshore activities and tax havens, one can learn a lot about the risks of classifying noncompliance as tax evasion by looking at past IRS offshore initiatives. Painting everyone with one brush can lead to programs that treat a taxpayer who has simply made a mistake in the same way as a taxpayer who has engaged in complex tax planning. For example, between 2009 and 2012, the Internal Revenue Service offered a series of settlement programs for U.S. taxpayers with unreported foreign bank accounts and income.[28] The initiative came in the aftermath of congressional hearings and a 2004 amendment to § 31 U.S.C. 5321(a)(5), which strengthened the penalties for underreporting the existence of foreign financial accounts, including a penalty of up to the greater of $100,000 or 50 percent of the maximum account balance for the period. Recognizing that not every failure to report was willful, however, the statutory scheme provided a flat $10,000 penalty for nonwillful failures to report and the discretion to impose no penalty at all where the failure to report had reasonable cause.

The IRS's 2009 Offshore Voluntary Disclosure Program (OVDP), on the other hand, provided for taxpayers to pay a flat 20-percent penalty of the highest account balance over a 6-year period as well as all other tax and interest on the unreported income, and a 20-percent accuracy-related penalty. The IRS simultaneously made clear that failure to enter the OVDP could result in an extensive audit and could also lead to criminal investigation. The 2009 OVDP thus failed to differentiate between those taxpayers who had small offshore accounts for family reasons (*e.g.,* providing support for a parent who lives overseas), or those taxpayers who, although being "accidental" U.S. citizens, had lived their adult lives without any professional nexus with the IRS and were surprised to learn they had an obligation to file returns with the IRS, and those taxpayers who were actively seeking to shelter their assets and income offshore so as to escape U.S. taxation. Although the IRS recov-

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port to Congress, Most Serious Problem: *Digital Currency: The IRS Should Issue Guidance to Assist Users of Digital Currency,* 249–255.

[26] *See* National Taxpayer Advocate, *NTA Blog: Wait, When Did This Virtual Currency Question Appear on My 1040 Tax Form,* March 3, 2021 at *https://www.taxpayeradvocate.irs.gov/news/nta-blog-wait-when-did-this-virtual-currency-question-appear-on-my-1040-tax-form2/; see also* Guinevere Moore, "IRS Rules on Reporting Bitcoin and Other Crypto Just Got Even More Confusing," *Forbes,* March 3, 2021 at *https://www.forbes.com/sites/irswatch/2021/03/03/irs-rules-on-crypto-reporting-just-got-even-more-confusing/?sh=2a393e487850.*

[27] IRS, *Tax Gap Estimates for Tax Years 2011–2013,* at *https://www.irs.gov/newsroom/the-tax-gap.*

[28] For an extensive discussion of the IRS offshore settlement programs between 2009 and 2018, *see* National Taxpayer Advocate, NTA Blogs: *An Analysis of Tax Settlement Programs as Amnesties: Part 1, Part 2,* and *Part 3* (March 14, 21, and 30, 2018).

ered $9.9 billion USD from these settlement programs through October 2016, the data for the 2009 OVDP paints a shocking picture of a regressive penalty structure, whereby the taxpayers with the lowest dollar accounts and least amount of unreported income paid the highest percentage rate of penalty (as a percentage of tax due on the unreported income). The 2009 initiative clearly violated the principle of proportionality, a fundamental taxpayer rights protection.

Figure 1. Comparison of Median Offshore Penalties to Unreported Tax by Median Account Size and Representation for the 2009 OVD Program

	Bottom 10%	Middle 80%	Top 10%
Offshore account(s) balance	$44,855	$607,875	$7,259,580
2009 OVD penalty	$8,540	$117,803	$1,410,517
Additional tax, tax years 2002–2011	$1,472	$30,894	$452,966
Offshore penalty as a percent of tax assessed	580%	381%	311%
Unrepresented percent	31%	11%	4%
Offshore penalty as a percent of tax assessed (unrepresented taxpayers only)	772%	474%	398%

Source: NTA Blog, March 21, 2018

An additional point about the offshore initiatives—they occurred during a time when the Department of Justice was successfully breaching the wall of Swiss bank secrecy. Whistleblowers were coming forward. IRS, Treasury, and Justice were all focused like a laser on offshore noncompliance. Taxpayers had a strong incentive to enter the programs. Yet when the programs ended in 2018, the IRS announced in a press release that it had collected $11.1 billion through the programs over the period of 2009 to 2018. That is a little over $1 billion a year, for 10 years.

ENHANCED INFORMATION REPORTING AND DATA USE CAN IMPROVE CASE SELECTION AND TAXPAYER SERVICE BUT IT REQUIRES A CHANGE IN IRS CULTURE, STAFFING, AND SYSTEMS

Intelligent use of data can improve tax administration enormously *if* it is fit for the purpose intended and used in algorithms and other techniques that mimic human reasoning and *if* it does not displace human decision-making and discretion. Data about a taxpayer's business or family status can identify services and information taxpayers need to meet their tax obligations and lead to more tailored and relevant communications; this information can minimize errors by enabling taxpayers to access their own information and download that information into return preparation programs;[29] it can identify taxpayers who are eligible for certain tax provisions such as the childless worker EITC and compute and refund credits when taxpayers fail to claim them; and it can identify questionable refund claims while at the same time minimize false positives and false negatives. Data also can ensure the IRS selects the most appropriate cases to audit.[30] IRS also can, and should, identify taxpayers at risk of economic hardship so the IRS does not take harmful collection action against them. However—and this is a big however—because there is so much pressure on the IRS to collect revenue, there is a risk the IRS will not deploy the data intelligently or effectively, and instead use enhanced information reporting to go after the lowest hanging fruit.[31]

[29] In 2011, for example, I recommended that Congress accelerate third-party information reporting and use that data to pre-populate returns. *See* National Taxpayer Advocate 2011 Annual Report to Congress, Legislative Recommendation: *Accelerated Third-Party Information Reporting and Pre-populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed,* 284–295.

[30] *See* National Taxpayer Advocate 2009 Annual Report to Congress, Most Serious Problem: *The IRS Does Not Have a Significant Audit Program Focused on Detecting the Omission of Gross Receipts,* 185–190.

[31] In 2011, in the introduction to a series of Most Serious Problems about the IRS questionable refund program, identity theft filters, math error assessments, automated substitute for returns, and automated lien filing procedures, I wrote about my concerns regarding the potential of automation to lead to taxpayer abuses. *See* National Taxpayer Advocate 2011 Annual Report to Congress, Most Serious Problem Introduction: *As the IRS Relies More Heavily on Automation to*

Today, IRS data use is mired in the 1980s, with some notable exceptions. There is heavy emphasis on data-matching and rule-based systems, instead of pattern/ network recognition algorithms that include feedback loops. The IRS underutilizes financial account data it receives pursuant to FATCA because it cannot match much of it to existing returns. The manner in which IRS receives data can limit its effectiveness. For example, in 2015 to 2016, the IRS created a program whereby it matched Forms 1042–S associated with the 1040–NRs filed by foreign students. Because IRS systems could not accept these returns electronically, IRS employees had to keystroke in the entries on the returns, including the 18 fields on Form 1042–S. The IRS sent out thousands of letters to foreign students (most of whom were no longer in this country) notifying them they had to obtain a corrected Forms 1042–S from their educational institutions since the payor data did not match their returns. Further investigation found over 90 percent of those "errors" were actually keystroke errors attributable to IRS data entry. The IRS's assumption that taxpayers themselves were to blame imposed undue burden on the taxpayers and educational institutions and created significant rework for the agency itself.[32]

Many IRS systems have high false positive and abatement rates. The National Taxpayer Advocate has reported that during the 2020 filing season, the IRS "refund fraud filters" selected 3.2 million returns, up 107 percent from the 2019 filing season.[33] Of those returns, the IRS approximately 66 percent of them were false positives.[34] *That is, two-thirds of the refund returns IRS systems labelled as potentially fraudulent turned out to be legitimate.* About 25 percent of the returns the IRS froze as potentially fraudulent took longer than 56 days to be unfrozen and released for processing and appropriate refund issuance.[35] While some of the delay may be attributable to closures during the pandemic, this high false positive rate associated with non- identity theft refund fraud filters has persisted for years—including 72 percent for the 2019 filing season.[36] These are very high rates, and they are exacerbated by the inadequate staffing and assistance to taxpayers who try to demonstrate the legitimacy of their returns. As a consequence, this issue has been #1 among case receipts for the Taxpayer Advocate Service for the last 4 years.[37]

Clearly, archaic data practices create burdens for taxpayers of all types and are especially harmful for the lowest-income taxpayers who depend on their refunds to meet basic living expenses. Moreover, these systems label legitimate returns as "potentially fraudulent," which has consequences with respect to how IRS employees view these taxpayers and the quality of assistance provided them. This points to the culture change necessary before the IRS can utilize data and advanced systems effectively.

The IRS also does not use data proactively to alleviate burden and prevent harm to taxpayers. I have advocated and written extensively about the need for IRS to use its taxpayer income data and the allowable expense guidelines developed under IRC § 7122(d)(2) to identify taxpayers who may be at risk of economic hardship.[38] The IRS can use this data both as part of its case selection and assignment criteria and as a tool to prompt its collection employees to gather sufficient financial information when a taxpayer calls or is contacted, in order to make an actual determina-

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Strengthen Enforcement, There is an Increased Risk it will Assume Taxpayers are Cheating, Confuse Taxpayers About Their Rights, and Sidestep Longstanding Taxpayer Protections, 15–17.

[32] For a detailed discussion of this issue, *see* National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress, Area of Focus: *IRS Implementation and Enforcement of Withholding on Certain Payments to Foreign Persons Is Burdensome, Error-ridden, and Fails to Protect the Rights of Affected Taxpayers,* vol. 1, 80, 82–83. *See also https://www.irs.gov/newsroom/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042-s-foreign-persons-us-source-income-subject-to-withholding.*

[33] The Pre-Refund Wage Verification Program, a component of RRP and administered by the Return Integrity Verification Operation (RIVO), freezes returns claiming refunds while the IRS attempts to verify wages and withholding claimed on the return. National Taxpayer Advocate, 2020 Annual Report to Congress, 230. RIVO utilizes "an obsolete case management and screening system called Return Review Program Legacy Component (RRPLC) (or Electronic Fraud Detection System), which the IRS has been planning to replace for more than a decade." *Id.* at 156.

[34] *Id.* at 151, note 19.

[35] *Id.* at 231; 18 percent took longer than 120 days for refund issuance.

[36] *Id.* at 151.

[37] *Id.* at 148.

[38] *See, e.g.,* Nina E. Olson, Procedurally Taxing: *My IRS Wishlist for 2021, Part 2: The Economic Hardship Indicator,* at *https://procedurallytaxing.com/my-irs-wishlist-for-2021-part-2-the-economic-hardship-indicator/;* National Taxpayer Advocate 2018 Annual Report to Congress, Most Serious Problem: *The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process,* 228–239.

tion as to the taxpayer's ability to pay a tax debt while paying for basic living expenses. The IRS has stubbornly refused to adopt this approach, asserting it does not have sufficient information to identify those risks.[39] This, of course, is simply not a credible assertion. Financial institutions and debt collection agencies make assessments like this every day with far less financial information than the IRS has at its figurative fingertips.

The shortcomings of a pure "matching" program without attendant intelligent programming are evidenced by the IRS's approach to math errors relating to dependent Taxpayer Identification Numbers (TINs). IRC § 6213(g)(2) authorizes the IRS to summarily assess additional tax by disallowing dependent exemptions, EITC, Child Tax Credit, and the child and dependent care credit where the qualifying child's TIN does not match Social Security or other records. In 2011, a research study conducted by my former office showed the IRS abated, at least in part, 55 percent of the summary assessments related to incorrect TINs, and in 56 percent of those returns with abatements, the IRS possessed internal information that would clearly show the source of the error (*e.g.,*, systemically reviewing past year returns to identify the taxpayer merely keystroked and inverted digits on the child's TIN in the current year).[40] The failure to do something so simple as an historical systemic review of taxpayer data on-hand demonstrates a disturbing lack of concern on the IRS's part with imposing undue and significant burden on taxpayers, who have to call or write the IRS to obtain their legally owed refunds. That the IRS has been aware of this problem (and its solution) since 2011 and has not prioritized fixing it, even when it is in the IRS's own best interests (because the programming will reduce phone calls and correspondence) is troubling indeed.

I raise these examples not as an objection to proposals for more information reporting, but rather to make clear that in addition to modernized technology and data integration and design, including a 360-degree taxpayer account, the IRS must have a culture shift about how it approaches data—including using it proactively to assist taxpayers, and guarding against labelling taxpayer returns as "potentially fraudulent" before it has conclusive evidence of fraud. Most taxpayer error is not fraud. Repeat as needed.

> *Recommendation:* Require the IRS to use to tax return and other information reports to proactively identify taxpayers who may be at risk of economic hardship.
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> *Recommendation:* Clarify the IRS may use its summary assessment authority under IRC § 6213 to make assessments with respect to refundable credits, such as the childless worker EITC, and similar items for which it has information that enable it to determine eligibility with sufficient accuracy and issue refunds accordingly.
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> *Recommendation:* Require the IRS, as a prerequisite to using summary assessment authority for an addition to tax, to utilize historical and other taxpayer account data to minimize the use of the summary assessment procedures.

ARTIFICIAL INTELLIGENCE SYSTEMS THAT LACK TRANSPARENCY AND DISPLACE HUMAN DECISION-MAKING AND DISCRETION MAY VIOLATE PRIVACY, HUMAN, AND TAXPAYER RIGHTS: CASE STUDIES FROM OTHER COUNTRIES

There are lessons to be learned from other countries' experiments with data use and artificial intelligence systems to identify fraud in welfare and tax credits. Data and AI can improve detection of noncompliance, but human intervention must be retained and these systems must adhere to basic principles of human dignity and privacy. Moreover, intelligent systems must not be designed as black boxes—they must transparent and explainable.

In 2016 the Australian government announced the Online Compliance Intervention (OCI), an automated debt recovery system that matched data from Centrelink with averaged income data from the Australia Tax Office.[41] As a result of several

[39] *See, e.g.,* IRS response to the Most Serious Problem, cited at note 35, in National Taxpayer Advocate FY 2020 Objectives Report to Congress, vol. 2, 93–94.

[40] National Taxpayer Advocate 2011 Annual Report to Congress, Research Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents,* vol. 2 at 113–144.

[41] Centrelink is a system that is administered by Services Australia, a government agency. Centrelink delivers payments and services for retirees, the unemployed, families, carers, par-

Parliamentary inquiries and several legal challenges, the program was scrapped in May, 2020, after it was alleged that 470,000 welfare recipients were wrongfully issued debt notices and paid these nonexistent debts in full. In June 2020, the Prime Minister apologized, and the government agreed to pay $720 million to the individuals who received the incorrect collection notices and paid the tax on the incorrect bill. In November 2020, the amount the Australian government committed to resolving the wrongful collection under this program expanded to $1.2 billion AUD to include settlement of a class action lawsuit.[42]

In 2020, the Hague District Court, reviewing a civil complaint filed by several nongovernmental organizations, found that the System Risk Indicator (SyRI), a system established by the Dutch government to use 17 types of data, including tax, assets, and social benefits, to identify various types of fraud in government programs, violated the European Convention on Human Rights Article 8 which provides a right to the protection of private life, including the protection of personal data.[43] Although this right may be interfered with in the interests of society, the court found that there was no balance between those interests because the system was not transparent—there was no information available about how it worked or what data was actually used, (*i.e.,* it was a black box) and there was no notification of the person when a person was flagged as a "fraudster" and information was passed on to prosecutors and police. This created a risk of discriminating and profiling against certain vulnerable groups of persons.

Finally, in January, 2021, the entire government of The Netherlands resigned after it was disclosed that a separate government initiative to investigate welfare fraud, including sharing and matching income information with other authorities, had resulted in parents being labeled as fraudsters and incurring thousands of euros in fines for simple mistakes, including missing signatures on forms. Moreover, the Dutch Data Protection Authority found the program was discriminatory against dual nationality citizens. The government announced that nearly 10,000 families will receive 30,000 euros (about $36,500) in damages.[44]

> *Recommendation:* To ensure AI systems comport with privacy and taxpayer rights protections and have the requisite level of transparency, the IRS should follow the practices recently recommended by the U.S. Administrative Conference of the United States.[45]

PROPOSALS TO EXPAND INFORMATION REPORT ARE PROMISING BUT SHOULD BE ACCOMPANIED BY ADDITIONAL TAXPAYER PROTECTIONS

With respect to specific proposals for expanded information reporting, I note that the information reporting proposal, Shrink the Tax Gap, from former Commissioner Rossotti targets the largest component of the tax gap—underreported unincorporated business income, and the related self-employment tax—and leverages information already compiled by financial and other institutions for issuance of a new information report, Form 1099–NEW.[46] Further, the proposal explicitly states it is not a "matching" proposal. Instead, it requires the highest income taxpayers in this category to reconcile their aggregate financial account deposits and withdrawals (reported on Form 1099–NEW) to the income and expenditures reported on their returns, and for the IRS to use this reconciliation to score returns based on a mapping of the reconciliation categories to audit results for those categories. Further, those taxpayers with incomes above a certain threshold and below the "reconciliation" threshold will still receive a Form 1099–NEW reporting their deposits and withdrawals. This form will put taxpayers on alert that the IRS has this information, and the IRS can use this information for real-time scoring of returns not subject to

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ents, people with disabilities, Indigenous Australians, and people from culturally and linguistically diverse backgrounds.

[42] *The Guardian,* "Robodebt Class Action: Coalition Agrees to Pay $1.2bn to Settle Lawsuit," November 16, 2020 at *https://www.theguardian.com/australia-news/2020/nov/16/robodebt-class-action-coalition-agrees-to-pay-12bn-to-settle-lawsuit.*

[43] *See Nederland Juristen Comite Voor De Mensenrechten v. The State of The Netherlands,* Hague District Court (February 5, 2020) (English translation at *https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBDHA:2020:1878*).

[44] *New York Times,* "Government in Netherlands Resigns After Benefit Scandal," January 15, 2021 at *https://www.nytimes.com/2021/01/15/world/europe/dutch-government-resignation-rutte-netherlands.html.*

[45] *See* Administrative Conference of the U.S., *Administrative Conference Statement #20: Agency Use of Artificial Intelligence* (December 16, 2020) at *https://www.acus.gov/recommendation/agency-use-artificial-intelligence.*

[46] *See* Shrink the Tax Gap proposals at *https://shrinkthetaxgap.com/*.

the reconciliation and use the results to identify potential noncompliance and to provide more detailed communication (non-audit) with taxpayers.[47]

One of the challenges with this proposal is the IRS's ability to execute it—the IRS today lacks the expertise and systems to achieve this level of sophisticated tax administration. It requires a sustained investment in leadership, technology, employees, training, and procurement. It is not really a matter of if the IRS can make these changes in its culture, because to fulfill its mission of collecting revenue and administering social benefit programs in the 21st century, it simply must change. All of this is achievable. The question is when and how it will make that change. Congress, through appropriations and oversight, including setting goals for the agency, is key to effecting this change.

There is a second challenge with this proposal. As noted above, it seeks to identify taxpayers who are underreporting their gross receipts of business income. Perhaps to target information reporting to the group most able to accommodate the administrative burden, it proposes that Form 1099–NEW reporting will be limited to business accounts, and related pass-throughs, of taxpayers reporting unincorporated business income whose adjusted gross income (AGI) is in the top quartile, currently about $92,000. The difficulty with this approach is that targeting information reporting in this way may imply, in many people's minds, the presumption that these taxpayers are evading tax. The other drawback to this approach is it relies on taxpayers' own self-reporting of gross receipts to identify taxpayers who are not properly reporting their gross receipts.

In 2007, as the National Taxpayer Advocate, I recommended that Congress require information reporting on all bank accounts as a measure to address cash economy noncompliance.[48] The IRS already received 1099 forms indirectly reporting the existence of interest- or dividend-bearing accounts. What was missing were the accounts that were non-interest-bearing. We believed the mere requirement of reporting the existence of these accounts would have a direct compliance effect, because taxpayers would know the IRS could, if it wanted to, look at the deposits in the minimal or non-interest-bearing accounts.

Thus, to avoid the appearance and implication that a targeted group of taxpayers whose account deposits and withdrawals are subject to information reporting are in some way *prima facie* noncompliant or tax cheats, I recommend Congress require financial institutions to report deposits and withdrawals on all accounts designated by the taxpayer as used for business, regardless of AGI levels. In this way the IRS can identify those taxpayers whose tax returns report income below the threshold in the Shrink the Tax Gap proposal but whose financial accounts show deposits significantly above that threshold.[49]

But I would not stop there, because if the IRS received this mother lode of data, it would be too tempting for it to resist falling back on its income matching techniques rather than utilizing the data in a more sophisticated and targeted way. If it did that, the IRS would be focusing its efforts on the lowest hanging fruit and not using the data to identify the most serious noncompliance, thereby defeating the entire purpose of the information reporting. Bank account information alone will not identify who the IRS should look more closely at, nor is it *prima facie* evidence of underreporting. Therefore, if Congress authorizes bank account information reporting, I recommend that it also restrict the IRS's use of this data by prohibiting it from utilizing it in the Automated Underreporter Program. While this restriction may seem counter-intuitive, I believe it is necessary to change the IRS's approach to the use of data and to bring it into the 21st century.

Finally, as noted earlier, many of the IRS's adjustments to returns occur outside of the traditional "audit" context. In FY 2019, the IRS closed 1.96 million automated underreporter assessments, and 365,000 automated substitute for return assessments.[50] These assessments historically have experienced high abatement rates. One reason for AUR and ASFR abatements is that these adjustments are made

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[47] Shrink the Tax Gap, Appendix E: Taxpayer Impact (April 7, 2021) at *https://shrinkthetaxgap.com/appendix-e-burden-model/*.

[48] National Taxpayer Advocate 2007 Annual Report to Congress, Legislative Recommendation: *Measures to Address Noncompliance in the Cash Economy,* 490–502.

[49] Some taxpayers, of course, will avoid designating accounts as business accounts and thus escape detection. There will always be these types of actors (asocial noncompliance). As noted above, no one proposal will address all forms of noncompliant behaviors. The Shrink The Tax Gap proposal will help close some of the unincorporated business underreporting tax gap, if not all.

[50] IRS, FY 2019 Data Book, Table 22.

based on third-party information reports, which may contain errors or be the result of identity theft (as in the recent case with pandemic-related unemployment insurance scams). Normally, the IRS's Notice of Deficiency (NOD) receives the presumption of correctness and taxpayers bear the burden of disproving it in Tax Court. Since 1991, however, Federal courts have consistently held that in court proceedings where a taxpayer disputes a proposed assessment based solely on a third-party document, the presumption that the subsequent NOD is correct does not automatically apply. This position is incorporated in IRC § 6201(d), which provides in any court proceeding the taxpayer "asserts a reasonable dispute" of the accuracy of an information reporting document and the taxpayer "fully cooperates" with the IRS, the government shall have the burden of producing "reasonable and probative information" concerning the proposed deficiency, beyond the information reporting document. There is, however, no complimentary provision to IRC § 6201(d) that requires an IRS audit employee to take on the burden of running down the underlying information where the taxpayer raises a reasonable dispute about an information document and cooperates in a "real" or "unreal" audit. Thus, I recommend that Congress extend IRC § 6201(d) to apply to IRS examination and matching activities, to ensure the proper use and application of expanded information reporting and to avoid unnecessary litigation.

> *Recommendation:* If information reporting is expanded to require financial institutions to report on the aggregate deposits and withdrawals for business accounts of sole proprietors and other pass-through entities, the use of this data in the IRS Automated Underreporter Program should be prohibited.
>
> *Recommendation:* Amend IRC § 6201(d) to require the IRS in examinations and in information document matching compliance programs to support a proposed assessment with "reasonable and probative information" beyond the information document, where the taxpayer has raised a reasonable dispute about that information document(s) and cooperated with the examination.[51]

TO ENSURE THE EFFECTIVE USE OF DATA AND THE PROTECTION OF TAXPAYER RIGHTS, CONGRESS SHOULD REQUIRE THE IRS TO CONDUCT A RIGHTS-BASED ADMINISTRATIVE BURDEN ASSESSMENT OF EACH NEW INITIATIVE, OVERSEEN BY THE OFFICE OF THE TAXPAYER ADVOCATE

In the course of its operations, the IRS must comply with various Federal statutes designed to minimize administrative burden, including the Regulatory Flexibility Act,[52] the Paperwork Reduction Act,[53] the Privacy Act,[54] and the Privacy Impact

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[51] For a discussion of a compelling case that makes clear just how important such protections are at the administrative level, *see* John A. Clynch and Scott A. Schumacher, Procedurally Taxing, *Oral Persuasion: Taxpayer Testimony and the Burden of Proof* at *https://procedurallytaxing.com/oral-persuasion-taxpayer-testimony-and-the-burden-of-proof/*. Congress should amend IRC § 7430 to provide for an award of attorney fees where the IRS fails to comply with its obligation under the amended IRC § 6201(d), even if the position of the IRS in Tax Court is "substantially justified." If the taxpayer has tried his or her best to provide information at the administrative level and is forced to keep providing it or to go to court because the exam and appeals level are not listening, then the taxpayer should be compensated.

[52] 5 U.S.C. §§ 601 et seq. The Regulatory Flexibility Act requires government agencies to make an initial flexibility analysis prior to publishing regulations for public comment, and a final regulatory flexibility analysis when publishing the final rule. In conducting these analyses, the agency must describe the effect of the rule on small business, analyze alternatives that might minimize adverse economic consequences, and make their analyses available for public comment. Agencies are relieved of performing this analysis if the agency "certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(b).

[53] 5 U.S.C. §§ 3501 et seq. The PRA seeks to "ensure the greatest possible public benefit from and maximize the utility of information created, collected, maintained, used, shared and disseminated by or for the Federal Government" and to "improve the quality and use of Federal information to strengthen decision-making, accountability, and openness in Government and society." 44 U.S.C. § 3501. To satisfy PRA requirements, prior to information collection agencies must (1) provide the public with an opportunity to comment on the information gathering activity; and (2) submit the proposal for collection of information to the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB). 44 U.S.C. § 3502(1).

[54] 5 U.S.C. § 552a. The Privacy Act establishes "fair information practices" requiring the IRS to (1) maintain in its records only such information "about an individual that is relevant and necessary to accomplish a purpose of the agency required to be accomplished by statute" (5 U.S.C. § 552a(e)(1)); (2) "collect information to the greatest extent practicable directly from the

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Assessment (PIA).[55] There are limitations for each of these regimes. The IRS has generally failed to make the flexibility analysis required by the RFA or perfunctorily stated that it need not conduct the analysis since it had determined the regulations would not have a significant impact on a substantial number of small businesses.[56] The PRA requires agencies to estimate the amount of time it takes to comply with a request for information, such as a Form 1040, but the definition of "time" is very narrow—it ignores other types of costs and other types of burdens, for example, downstream burdens including audits, summary assessments, and collection actions. With respect to the Privacy Act, IRS disclosure laws trump the Privacy Act in many instances, so compliance with the Act is difficult to measure. The Privacy Impact Assessment, on the other hand, is a system of guiding program owners through a process of assessing privacy risks during the early stages of development as well as through the life cycle of the system. The PIA can go beyond just assessing the "system" itself and consider the "downstream" effects on people who are affected in some way by the proposal. The PIA, however, does not explicitly address the taxpayer rights implications of a proposed program or system.

To address this gap, in an upcoming article Professors Leslie Book and Keith Fogg and I are proposing a rights-based framework for assessing the excessive administrative burden and taxpayer rights impact of a given IRS initiative or system.[57] Our framework acknowledges that where there is evidence of broad-based, systemic noncompliance, developing programs which increase up-front administrative burdens on taxpayers in order to facilitate downstream compliance may be justified in order to protect program integrity (and even enable continuation of the program). However, where a program impacts a significant number of individuals, even one with a superficially large monetary impact, but one where the incidence of noncompliance occurs within a small percentage of taxpayers, the problem may not justify a solution which imposes a disproportionate administrative burden on all taxpayers.

The rights-based administrative burden framework requires the Service to expand its horizon and think more holistically about how it interacts with taxpayers. It focuses on the relationship between the Service and the taxpayer, and requires the IRS to consider the distributional impact of the burdens it imposes, minimizing the risk that its actions are arbitrary. Under this analysis, the critical questions are, did the Service consider taxpayer rights in taking this action or designing this system? And, is the Service ignoring taxpayer rights by *not* taking an action?

An initial challenge with this approach is how to require the Service to be more cognizant of how its actions impose excessive administrative burden and harm on particular taxpayer populations and sub-populations *before and during* program design and implementation. Building on elements present in the PRA, the Privacy Act, and the PIA, we recommend the IRS conduct a Taxpayer Rights Impact Statement (TRIS) with respect to all prospective programs. Additionally, we propose a method for systematic review of existing programs. By adopting the Privacy Act's approach to transparency, the Taxpayer Rights Impact Statements (TRIS) resulting from these reviews should be required to be posted on a dedicated, public webpage on the agency's website. Finally, the application of the framework requires the Service to measure different impacts from its current practices, which in turn will require the Government Accountability Office (GAO) and the Treasury Inspector General for Taxation (TIGTA) to shift their audit focus.

While this approach seeks to protect all taxpayers from excessive administrative burdens, it must look at those *disproportionately* impacted which may result in an analysis for a particular subset of taxpayers. If the IRS is proposing an initiative that affects 75 to 100 percent of overseas taxpayers and few domestic taxpayers, the overall program may appear appropriate yet it has a disproportionate impact. An

[taxpayer]" (5 U.S.C. § 552a(e)(2); and (3) maintain the records it uses in making a determination concerning a taxpayer "with such accuracy, relevance, timeliness and completeness as is reasonably necessary to assure fairness to the individual in the determination." (5 U.S.C. § 552a(e)(5).

[55] Pub. L. No 107–347, § 208(b), 116 Stat. 2922 (2002).

[56] In a Government Accountability Office ("GAO") review of 200 tax regulations issued from 2013 to 2015, only two preambles included an RFA analysis. GAO–16–720, Regulatory Guidance Processes: *Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance* 22 (2016). In approximately half of the regulations reviewed by GAO Treasury and the IRS claimed that the "RFA's requirements for a regulatory impact analysis did not apply because the regulation does not impose a collection of information requirement on small entities." *Id.* at 22

[57] A working draft of this article, *Administrative Burdens, Sludge, and Taxpayer Rights,* is available at *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3545357*.

example here might occur if the Service does not have any toll-free overseas lines, does not allow email communications, and does not allow overseas taxpayers to establish online accounts. This creates an excessive administrative burden given the characteristics of the population of overseas, and violates the right to quality service, the right to challenge the IRS and be heard, and the right to a fair and just tax system, among others. The TRIS would require the IRS to identify these gaps and propose mitigation strategies prior to implementing the initiative.

Under our proposal, the Service would conduct this rights-based administrative burden assessment for both customer service and compliance programs and systems. We define compliance programs and systems as broad in scope—including notices, refund claim freezes, automated matching compliance programs, audits, collection actions, collection alternatives, public filings of notices of Federal tax liens, and passport denials. Customer service programs include online self-service, automated and live telephone assistance, in-person assistance as well as outreach and education initiatives, including notices. At the outset, we anticipate this analysis to be conducted on programs that operate across the entire program areas of the Service; where regional or local programs propose deviations from the broader program approach, they will be required to conduct a similar review.[58]

We recommend placement of the design and oversight of the TRIS process within the Office of the Taxpayer Advocate. This arrangement would ensure the process is driven by the external, taxpayer-oriented perspective of the NTA. We envision the TRIS process working as follows:

1. When an IRS function proposes a new initiative, the IRS program owner will complete a questionnaire that assists the agency in identifying whether there is a significant likelihood the program's administrative burden will deprive the protected taxpayer segment of a fundamental taxpayer right, including undermining the public policy goal for the program.
2. The completed questionnaire will be circulated to appropriate agency personnel, including the Office of the Taxpayer Advocate and the Office of Chief Counsel, as well as operating divisions that are affected both upstream and downstream by the program proposal.
3. All comments will be addressed by the program owner, with attendant internal discussions as necessary.
4. Where the NTA determines the IRS has not addressed the concerns she or others have identified, the initiative will not go forward until these concerns are addressed. Functions will be able to appeal the NTA's determination to the Commissioner or appropriate Deputy Commissioner.[59]
5. The taxpayer rights and administrative burden analysis, including the risks to fundamental taxpayer rights and discussions of mitigations, will be documented in a Taxpayer Rights Impact Statement that is posted to the agency's dedicated webpage for public viewing, similar to the public posting of Privacy Impact Assessments.[60]

The framework and approach discussed above accomplishes several things. First, it requires the Service, *before programs are implemented,* to identify under-resourced populations that are affected by its actions; to articulate how the design of agency programs may undermine taxpayer protections or access to benefits, based on the specific characteristics of the taxpayer segment; and to make recommendations to mitigate those burdens. Second, it requires that the Service's assessment—the Taxpayer Rights Impact Statement and the related questionnaire—is posted on the agency's website so the public, Congress, and IRS oversight agencies can see how the Service is conducting the rights-based administrative burden framework. This transparency will enable stakeholders to raise concerns where the analysis provided by the Service has fallen short, and it provides an important tool to conduct ongoing oversight of the agency. Third, and most important, it is the first step in driving a culture change in the agency, where it recognizes its dual mission as both a revenue collector and a social benefits administrator. The framework analysis will

[58] In our article, we set forth a procedure for applying the framework to programs already in existence.

[59] This approach is consistent with that enacted by Congress in I.R.C. § 7803(c)(5)(A) and (B), which provides a process for appeal to the Commissioner of any Taxpayer Advocate Directive issued by the National Taxpayer Advocate and rescinded or modified by the Deputy Commissioner. The approach is also modeled on the IRS processes for Privacy Impact Assessments, which are overseen by the Office of Privacy, Government Liaison, and Disclosure. *See* IRM 10.5.2.2 for the requirements for IRS Privacy and Civil Liberties Impact Assessments.

[60] The IRS's Privacy Impact Assessments are available at *https://www.irs.gov/privacy-disclosure/privacy-impact-assessments-pia.*

require the Service to establish different measures of program success, which in turn will require the agencies auditing its performance to shift their audit focus of these programs solely from measures of revenue collected to measures of taxpayer burden and rights impaired.

Recommendation: Amend the Internal Revenue Code to require the National Taxpayer Advocate to develop a rights-based administrative burden analysis process; require the IRS to follow that procedure with respect to the development and implementation of major initiatives; and require posting of such analysis and the accompanying Taxpayer Rights Impact Statement on a dedicated public webpage.

ADDITIONAL RECOMMENDATIONS TO PROTECT TAXPAYER RIGHTS IN AN ENVIRONMENT OF INCREASED INFORMATION REPORTING

In addition to the recommendations mentioned above, I recommend that Congress enact or amend the following the provisions so taxpayers can ensure the IRS administers these new technologies and sources of data appropriately, in accordance with taxpayer rights and not arbitrarily and capriciously.

1. *Clarify certain time frames are claims processing deadlines and not jurisdictional.* The United States Tax Court has consistently held that certain statutory time periods for seeking judicial review are jurisdictional; thus, if the taxpayer misses the deadline for filing by one day, even where the lateness is due to good cause or even no fault of the taxpayer's, the Tax Court will dismiss the case for lack of jurisdiction.[61] The United States Supreme Court has held, in other contexts, that jurisdictional time frames must be explicitly described as such in the statute; otherwise the time frames should be treated as claims processing rules, subject to equitable tolling.[62] I recommend that Congress amend the code to make clear that except where explicitly stated, the time periods for seeking judicial review or seeking relief from the IRS are not jurisdictional but are claims processing rules subject to equitable tolling if the taxpayer has good reason for missing the deadline. This clarification is particularly important in the context of IRC § 6213(a) (deficiency jurisdiction); IRC § 6015 (relief from joint and severability); and IRC §§ 6320 and 6330 (collection due process hearings).[63]
2. *Extend certain time frames by 60 days when the taxpayer is outside of the United States at the time of notice issuance.* IRC § 6212 extends the deadline for filing a petition in the Tax Court by 60 days where the taxpayer is outside of the United States. There are many other provisions providing taxpayers the right to administrative and judicial review where such an extension for international taxpayers would protect those rights, including petitions to appeal IRS denials of relief from joint and several liability under IRC § 6015(e) and petitions to appeal from IRS Collection Due Process Determinations under IRC § 6330(d)(1).
3. *Repeal the "full-pay" requirement for refund litigation in Federal district courts and the U.S. Court of Federal Claims.* In *Flora v. United States,* 362 U.S. 145 (1960), the United States Supreme Court held that, with a few exceptions, taxpayers must fully pay a tax liability before filing a refund suit in a U.S. district court or the U.S. Court of Federal Claims under IRC § 7422. This rule deprives taxpayers who cannot full pay, including taxpayers who the IRS has determined to be "currently not collectible" because of economic hardship, of the opportunity to press their refund claims in court. Moreover, taxpayers who do fully pay under lengthy installment agreements will not be able to recover all their payments if they ultimately prevail in court, because under IRC § 6511(b)(2)(B), such refunds are generally limited to those payments made within 2 years before the date of filing the refund claim. Further some assessable penalties, which are not subject to deficiency procedures, may be so large

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[61] *See, e.g., Castillo v. Commissioner,* Docket No. 18336–19L (order dated March 25, 2020) (notice of determination mailed by IRS to taxpayer's last known address but never delivered by post office—case dismissed for lack of jurisdiction due to untimely petition) (appeal pending at Second Circuit, Docket No. 20–1635). The Center for Taxpayer Rights has filed an amicus brief in this appeal.

[62] *See Henderson v. Shinseki,* 131 S. Ct. 1197, 1203 (2011) (indicating a preference that claim-processing rules, which require parties to take certain steps by certain times in order to promote the orderly progress of the matter, should not be treated as jurisdictional.)

[63] For a detailed discussion of this issue, *see* Bryan Camp, "New Thinking About Jurisdictional Time Periods in the Tax Code," 77 *Tax Lawyer* 1 (2019).

that the prepayment requirement deprives a taxpayer of any ability to challenge the penalty in court.

In the event full repeal is not possible, I recommend Congress adopt the National Taxpayer Advocate's recommendations to address this issue:[64]

- Amend IRC § 6212 to expand the deficiency process to cover all penalties in title 26, including the penalties located in chapter 68, subchapter B, and those located in chapter 61, so that taxpayers can obtain judicial review by the Tax Court before they are assessed.
- Clarify that a person is not required to fully pay before filing suit in a U.S. district court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346(a)(1) (*i.e.,* repeal the *Flora* court's full payment rule).
- Amend IRC §§ 7442 and 7422 to give the Tax Court jurisdiction to determine liabilities in refund suits to the same extent as the U.S. district courts and the U.S. Court of Federal Claims, without regard to how much of the liability has been paid.

4. *Amend IRC § 3401(p)(3) to explicitly authorize voluntary withholding agreements between independent contractors and service recipients.* According to the IRS, the portion of the tax gap attributable to underpayment is $50 billion.[65] The requirement that platforms must now issue a Form 1099–K where payments to a service provider is $600 or more per year will bring surface previously unreported income. Allowing independent contractors and service providers to voluntarily agree to withholding on payments will avoid increasing the underpayment tax gap even as the underreporting tax gap is reduced.
5. *Allow certain contests of regulations outside of case specific contexts.* In other areas of law, interested parties generally have the opportunity to litigate the application of the Administrative Procedure Act (APA)[66] to rules and regulations before the agency enforces those rules against the public. The ability to generate prompt court review helps ensure that agencies comply with the APA by appropriately seeking and applying input from the public when promulgating rules that have the force and effect of law.

Tax law, however, differs from this norm. Because of the Anti-Inunction Act (AIA),[67] parties only generally have an opportunity to judicial review of IRS APA compliance during enforcement proceedings or in refund litigation. Those proceedings can arise years after the guidance is promulgated. Any challenge requires disobeying the rules or complying with the rule, paying any associated taxes and penalties, and seeking a refund.

The tax system's limited opportunity for court review means that taxpayers and third parties may not have a meaningful opportunity to challenge IRS actions. While there is litigation pending before the Supreme Court in the case of *CIC Services v. Commissioner* that may create some additional pre-enforcement opportunities to challenge certain rules or regulations, Congress should provide a uniform legislative path to prompt court review. That would allow for earlier efficient resolution of possible disputes and help ensure that IRS actions are consistent with the APA before taxpayers and third parties are placed in the difficult of either (1) complying with a rule that may be in conflict with the APA or (2) failing to comply with a rule and subjecting themselves to penalties for that noncompliance.

In the last few years, academics have highlighted this problem and offered legislative solutions. For example, in the article "Restoring the Lost Anti-Injunction Act," Professor Kristin Hickman and Gerald Kerska propose legislation that would allow an opportunity for parties or persons affected by agency rules or regulations to seek court review to ensure compliance with the APA in a defined, prompt, and orderly manner. They propose a legislative amendment to the AIA that would allow judicial review of IRS rules or regulations

[64] *See* National Taxpayer Advocate 2018 Annual Report to Congress, Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can,* 364–386. *See also,* National Taxpayer Advocate 2020 Purple Book, *Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can,* 82–84.

[65] IRS, *Tax Gap Estimates for Tax Years 2011–2013* at *https://www.irs.gov/pub/irs-pdf/p5365.pdf.*

[66] 5 U.S.C. §§ 500 et seq.

[67] IRC § 7421.

in both the pre-enforcement and enforcement context.[68] This legislative change would help ensure that the IRS acts lawfully and in a manner that appropriately seeks and reflects public input. I recommend Congress adopt the Hickman-Kerska proposal.

QUESTIONS SUBMITTED FOR THE RECORD TO NINA E. OLSON

QUESTIONS SUBMITTED BY HON. SHELDON WHITEHOUSE

Question. The county with the highest audit rate in the country is a poor, mostly black county in Mississippi where over half of the taxpayers claim the EITC and the median annual household income is $26,000.

How could the IRS effectively use information reporting and new technology as former IRS Commissioner Rossotti and the Biden administration have proposed to better focus its audit resources on the very wealthy, who are more likely to underreport their income than other income groups?

Answer. Some level of compliance touches is appropriate for every component of the tax gap. However, the IRS "audit rate" of low-income taxpayers who receive the EITC understates the amount of compliance contacts these taxpayers experience, because the IRS does not include in its audit rate calculation the data on programs such as summary assessment authority (math errors), automated underreporter, or automated substitute for return. I call these programs "unreal audits" because although the IRS doesn't classify them as a "real" audit, they sure feel like an audit to the taxpayer and they have the same potential consequences as an audit, *i.e.,* an additional assessment of tax. IRS data show that it issued 1.872 million Math Error notices in Fiscal Year 2019 (per FY 2019 IRS Data Book Table 23) compared with 680,543 individual returns audited that same year (per FY 2019 IRS Data Book Table 17b). Thus, the IRS conducted almost 3 times as many math error touches as it did individual audits.

The noncompliance addressed by these unreal audit programs is low-hanging fruit and is the result of rudimentary data or document matching. To address the more sophisticated noncompliance described in former Commissioner Rossotti's proposal, the IRS will need a combination of additional information reporting, highly skilled employees, and advanced technology. Information reporting of financial account deposits and withdrawals, especially focused on pass-through entities and their owners/partners/shareholders, can provide a clearer picture of relationships between those entities and underreporting by them. But this information cannot be used as *prima facie* evidence of noncompliance—that is, the existence of a discrepancy between bank deposits and reported income alone is not and should not be considered conclusive of underreporting, absent other evidence; that is why I recommend that Congress prohibit the use of these information reports in the IRS Automated Underreporting Program and amend IRC 6201(d) to extend its taxpayer protections to IRS audit and document matching programs. This information reporting is best used as an indicator to identify accounts requiring further investigation; alternatively, it can be used to identify taxpayers we don't need to worry about. The information should be used in conjunction with sophisticated modelling techniques and other taxpayer data to better focus IRS audit resources on those taxpayers who will not respond to other, less intrusive compliance touches.

Question. Would the IRS be able to make effective use of this information and new technology without major, sustained investment?

Answer. The IRS is profoundly behind the rest of the developed world's tax administrations in terms of technology, employee training and skillsets, and effective use of data. For the IRS to provide 21st-century customer service and address 21st-century noncompliance, it will need sustained investment over a decade and longer.

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[68] Kristin E. Hickman and Gerald Kerska, "Restoring the Lost Anti-Injunction Act," 103 *Va. L. Rev.* 1683 (2017); Stephanie Hunter McMahon, "The Perfect Process Is the Enemy of the Good Tax: Tax's Exceptional Regulatory Process," 35 *Va. Tax Rev.* 553 (2016).

The legislative amendment Hickman and Kerska propose is as follows:

Notwithstanding section 7421(a), not later than 60 days after the promulgation of a rule or regulation under authority granted by this title, any person adversely affected or aggrieved by such rule or regulation may file a petition for judicial review of such regulation with the United States Court of Appeals for the District of Columbia or for the circuit in which such person resides or has their principal place of business.

But investment is not enough—Congress must undertake the necessary oversight to ensure that the IRS uses this investment appropriately. There are technology and systems available today in the private sector that the IRS could utilize relatively quickly, but it needs employees with the vision and training to effectively use that technology. IRS needs to recruit leaders and employees from outside the IRS with those skills and invest in its current employees in terms of training—especially encouraging them to pursue advance degrees in computer science, data engineering, data ethics and philosophy, as well as law and accounting. Without highly skilled, visionary, and creative employees, technology is just that—technology. And without improved technology and employees with advanced skillsets, additional information reporting will be underutilized, or worse, lead to inaccurate results (both false positives and false negatives).

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. Your written testimony states that IRS's initiative to crack down on offshore tax noncompliance over the last decade occurred when the IRS, Treasury, and the Department of Justice (DOJ) were focused "like a laser" on offshore noncompliance. It was also during a time when the DOJ was breaching the wall of Swiss bank secrecy, as your testimony states. Yet when the programs ended in 2018, the IRS announced it had collected $11.1 billion through the programs over the period of 2009–2018—a little over $1 billion a year, for 10 years.

What lessons can be learned from the IRS's Offshore Voluntary Disclosure Program?

Answer. One of the main lessons we can draw from the IRS Offshore Voluntary Disclosure Programs is that one size does not fit all. In the early years of the program, the IRS offered the same "deal" to taxpayers who had very low dollar offshore accounts and were only inadvertently noncompliant (*e.g.,* "accidental Americans") as it offered to taxpayers who were actively and intentionally sheltering significant income and account balances offshore. The IRS treated all taxpayers with offshore accounts as if they were actively evading tax; it treated the benign actors the same as the bad actors. This led to profoundly regressive penalties on taxpayers with small account balances or who were unrepresented. The approach increased fear and anger toward the IRS and eroded trust; on the other hand, it brought in relatively modest amounts of tax and penalties over the 10-year period the programs ran. I believe a better-designed program would have brought in at least as much, without the erosion of taxpayer trust, which may lead to taxpayers finding other ways to not comply.

The 2009–2018 OVDP shows that to tackle difficult issues like offshore noncompliance, the Service needs a nuanced compliance strategy based on the understanding that the tax gap is not solely made up of tax evasion. For example, the IRS could have analyzed the legitimate reasons individuals had offshore accounts (*e.g.,* to care for overseas relatives) as well as the historical or cultural reasons (*e.g.,* inherited Holocaust accounts), and developed settlement programs and pathways for those taxpayers to come into compliance without a shaming component. These initiatives would be different from the compliance strategy for taxpayers who took steps to actively avoid or evade tax. This approach comports with the taxpayer's *right to a fair and just tax system*—one that takes into consideration the taxpayer's facts and circumstances in determining their tax liabilities and ability to pay.

Question. Can you discuss the role and importance of high-quality IRS customer service and how it helps with voluntary tax compliance? What are up to three recommendations you have, if any, for the IRS to improve its customer service to taxpayers?

Answer. IRS tax gap data show that the majority of U.S. taxpayers voluntarily comply with, or are trying to comply with, our country's complex tax laws. Only 2 percent of the over $3.5 trillion the IRS collects each year is directly attributable to IRS enforcement actions; taxpayers pay the remaining 98 percent for a variety of reasons, including wanting to be compliant and not wanting to get mixed up with the IRS. Customer service plays a key role in promoting and enabling voluntary compliance and helping taxpayers get it right from the start; if it is difficult for taxpayers to get answers to their questions, they will make mistakes; if they make mistakes and they cannot resolve the problem quickly, they will resent the amount of time they must spend; if they have to pay for assistance and representation to resolve the matter, they will resent having to make that expenditure. That resent-ment can lead taxpayers to take noncompliant actions in the future, as a way of making up for the burden, cost, and anxiety attributable to poor customer service and misguided enforcement actions. Thus, taxpayer service maximizes voluntary compliance by providing information to taxpayers and making it easy for most taxpayers to comply with the tax laws; by providing prompt, accessible, and comprehensive assistance when problems arise; and by explaining to taxpayers what they did wrong and by listening to taxpayers in order to learn where the tax agency is wrong.

The three priority areas in which IRS can improve taxpayer service, and thus have a positive impact on voluntary compliance, are:

1. *Improve phone assistance.* The IRS needs to both increase the staffing it assigns to all its phone lines and establish higher goals for the level of service on the phones. Customer call-back technology will reduce taxpayer frustration, but taxpayers have demonstrated they want and need information directly from the IRS and they want to speak with a live human being when problems arise and receive specific, not canned, answers. This can only be resolved by increasing the number and training of IRS phone assistors. Further, the IRS needs to extend its tax law assistance phone line throughout the year, instead of shutting it down after April 15th of each year. Finally, the IRS should establish a dedicated toll free phone line, open throughout the year, to answer questions from taxpayers about Earned Income Tax Credit and Child Tax Credit eligibility; enabling taxpayers to speak with someone about their family situation and eligibility *before* they file their return (or claim the Advance CTC) will help reduce errors and overclaims.
2. *Improve notice clarity.* Despite many efforts over the years, the IRS still sends out notices that are models of un-clarity. For example, it is impossible to tell from the face of a math error notice what, exactly, the IRS has changed on the return. The taxpayer must call or write the IRS to figure out the what the error is and whether the taxpayer agrees with it. Other notices do not alert taxpayers to significant taxpayer protections that are available, including the right to challenge a proposed deficiency or collection alternative in Tax Court before paying the tax. While the IRS notice system is cumbersome and needs updating or replacement, all IRS notices can be improved today, without updated technology, by applying a rights-based approach to notice writing. Taxpayers have the *right to be informed;* notices should be educational and clearly explain what the problem is, what taxpayers can do to get help and resolve the problem, what taxpayer protections are available, and what deadlines apply.
3. *Use Automation and Data to Reduce Taxpayer Burden.* The IRS should identify ways in which it can use data to minimize taxpayer burden and provide better assistance to taxpayers. Better use of data and artificial intelligence can reduce the false positive rate attributable to questionable refund rules and models, so fewer legitimate returns are frozen each year and fewer taxpayers experience unnecessary delays in receiving their refunds (which generate more phone calls). Similarly, IRS could use internal historical return data to identify simple math errors such as a switched digit in a dependent's social security number; the IRS could fix this error internally and issue a math error notice, which in turn would prompt the taxpayer to call. A 2011 Taxpayer Advocate Service study showed that 55 percent of math errors attributable to dependent taxpayer identification numbers were later abated in whole or in part, and of those abatements, 56 percent of them could have been detected and corrected by the IRS from its own internal data sources. Such an approach would reduce taxpayer burden and free up IRS resources to address other issues.

Question. Do you have any additional comments that you would like to share about the IRS Commissioner's $1-trillion guestimate about the tax gap?

Answer. Estimating the tax gap is very difficult, and many tax administrations around the world do not try to do so because such an estimate is necessarily based on assumptions and imperfect data sets. The IRS has spent years developing the National Research Program (NRP), which it uses to estimate the tax gap. The NRP was heavily negotiated with Congress and others in order for the IRS to resume conducting random audits, following the cessation of its predecessor, the Tax Compliance Measurement Program (TCMP), because of overly burdensome audits. I believe making guestimates of a $1-trillion tax gap, without any rigorous analysis to back up that number and without making that analysis available for scholarly and objective review, undermines the integrity of tax gap estimates and leads to an environment in which the tax gap is equated with tax evasion, rather than conducting the more nuanced analysis it requires.

Question. Based on your experience, does the IRS have the institutional capacity and expertise to successfully implement Mr. Rossotti's proposal to narrow the tax gap? Are there sufficient safeguards in the proposal to protect taxpayers from enforcement abuse? If not, what are the most important safeguards you would recommend?

Answer. The IRS today lacks the enhanced technology and enhanced employee skills to successfully implement former Commissioner Rossotti's proposal. Attaining such skills and technology will require an investment in the IRS, and sustained oversight by Congress to ensure the investment is properly applied. This investment is necessary to improve the IRS's ability to meet the sophisticated tax compliance challenges in a global economy. I am concerned, however, that without more safeguards the IRS will use financial account data in the way it currently uses much of its data from information reporting, namely by document matching. This approach will pick up "low-hanging fruit" but will not achieve the proposal's intended compliance effect. Thus, if the IRS is authorized to receive reporting of financial account deposits and withdrawals, I recommend that it be prohibited from using this data in its Automated Underreporter program, since the mere existence of a discrepancy between financial account deposits is not *prima facie* evidence of underreporting. This prohibition will force the IRS to use the data within a more sophisticated, artificial intelligence-based system that should result in more accurate audit selection and minimal false positives. I also recommend that Congress extend the protections of IRC § 6201(d) to IRS examination and information document matching compliance programs. section 6201(d) currently requires the IRS, in Tax Court, to support a proposed assessment with "reasonable and probative information" beyond the information document, where the taxpayer has cooperated with the IRS.

PREPARED STATEMENT OF HON. CHARLES O. ROSSOTTI, FORMER COMMISSIONER (1997–2002), INTERNAL REVENUE SERVICE

Mr. Chairman and Ranking Member, thanks for allowing me to testify on how to shrink the ever-growing tax gap.

We estimate that the amount of taxes that were legally owed but not paid was $574 billion in 2019 and will accumulate to $7.5 trillion over 10 years. This amount in 2019 was equal to what the lower 90 percent of individuals, 135 million taxpayers, paid in Federal income taxes. Commissioner Rettig recently testified the tax gap may be even larger than that.

We estimate that it is practical to recover $1.4 trillion of this tax gap over 10 years, which is still only 19 percent of the total. All this gain would be from the top 25 percent of taxpayers and the majority from the top 3 percent.

Tax compliance is heavily driven by whether a taxpayer's income is reported by third parties in a manner that the information can be efficiently used by the IRS. Where income is reported and easily checked from forms such as W–2s and 1099s, compliance is 95 to 99 percent. Almost all the tax on that income is paid voluntarily without IRS intervention. Where income is not reported, compliance is as low as 50 percent.

Our plan for shrinking this tax gap is based on an integrated three-part program. First, move more income from low visibility to higher visibility by filling the gaps on income that is not reported by third parties to the IRS. Second, upgrade IRS technology to make full use of all the information available to the IRS to increase the effectiveness and efficiency of all IRS compliance activities. Third, rebuild IRS's skilled workforce and provide them technology to resolve taxpayer cases more rapidly and efficiently.

It is critical to use technology to make the entire compliance process far more efficient because simply scaling up what the IRS does today will not produce the desired results. Currently, all of IRS auditing activity recovers only about 2.5 percent of the tax gap.

For example, the IRS today cannot efficiently evaluate information on 40 million K–1 forms, on the 1099–K reports from payers, or on submissions required by FATCA. Modern technology can effectively use this information to identify potential deficiencies.

Technology will also allow the IRS to transform the follow-up process when deficiencies are identified to one that is far more accurate and efficient for taxpayers and the IRS than traditional auditing. The technology we propose is not futuristic. It is widely used today including on a limited scale in the IRS, for example in screening refunds.

Most of the gain in our plan comes from increased voluntary compliance so it is essential to make compliance as easy as possible. The investments we propose would increase the ease and speed of dealing with the IRS and reduce the number of unnecessary audits.

We also recommend that this committee follow its bipartisan practice of establishing pertinent taxpayer rights when it considers legislating authority for the IRS and our plan proposes several new or clarified taxpayer rights.

Our program requires both authorization and consistent long-term funding from Congress. We recommend a funding increase of about 6 percent per year above what is required to sustain IRS operations. Spreading this increase over 10 years is what will allow the IRS to make effective use of the funds Congress is providing. Over a decade this investment will produce a revenue gain of about 20 times its cost and will vastly increase the quality of service the IRS provides to taxpayers.

Implementing this program will be challenging, but based on my 50 years of managing programs in business and government I believe it is achievable and clearly outbalances any risks. As Congress did when it passed the IRS Restructuring and Reform Act, compliance and service goals can be established, progress could be measured year-by-year and closely monitored by congressional oversight committees.

I note that our proposals are for long-term investment. In the short term, the IRS must focus on the immediate priorities of the filing season, the economic recovery program and the new child tax credit.

Finally, I believe that fundamental fairness alone is a compelling reason to address this problem, particularly when Congress is contemplating raising taxes on people who already pay what they owe.

SUMMARY OF SHRINK THE TAX GAP PLAN

One Minute Explanation of How to Recover $1.4 Trillion Over 10 Years From Taxes Already in the Tax Code

The tax gap is all the taxes that are owed but not paid: $574 billion in 2019, and it has been growing every year.

Our shrink the tax gap plan has three elements:

1. *Fill the gap in information reporting.* Most taxpayers have no choice about paying their tax, because their income is reported by third parties on familiar documents like W–2s and 1099s, so their compliance is 95 percent. But where there is no reporting, as in much business income, compliance is as low as 50 percent. Our plan moves more income into higher visibility categories through the addition of one 1099 information report on business income of the top income quartile of taxpayers and their businesses.
2. *Upgrade technology* to identify underreported income, to make the follow-up process more efficient, and to improve service to all taxpayers.
3. *Effectively focus and streamline auditing.* We would transform auditing to be an essential but a supporting element to complete the follow up process and to deal with complex cases.

We estimate that this plan would shrink the tax gap by 19 percent over 10 years, gaining about $1.4 trillion, almost as much as President Biden's proposal to increase individual income taxes. All this revenue gain would be from taxpayers in the top quartile of income and most of it would come from increased voluntary compliance. The revenue gain would be about 20 times the cost.

Since most revenue comes from voluntary compliance, making it easier for taxpayers to comply is essential. Our plan would increase IRS increase service to levels to commercial levels. Treating taxpayers fairly, even when there is a dispute, is also essential and our plan proposes expanding taxpayer right.

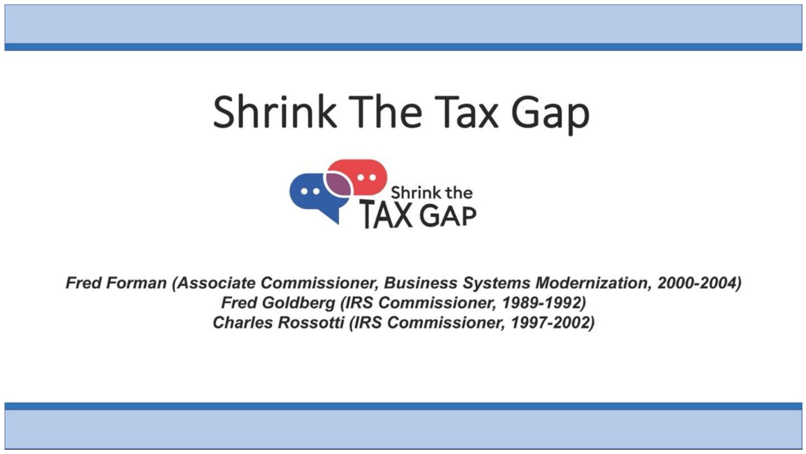
Our plan is a major long-term program that would require congressional action to provide direction, authority and a source of assured funding of about 6 percent per year increase over what is needed to sustain IRS operations.

All the details are available at *shrinkthetaxgap.com.*

SHRINK THE TAX GAP PRESENTATION

This document presents the current version of our STTG plan as of May 3, 2021. We regularly update our plan to reflect comments and further research.

Shrink the Tax Gap Authors

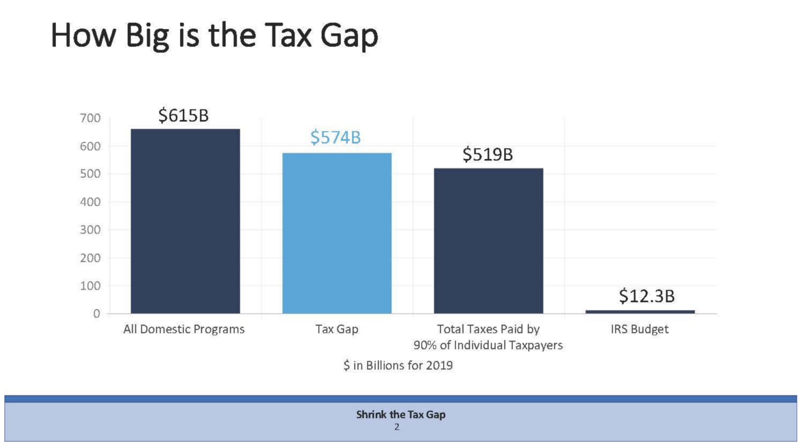


Fred Forman, Fred Goldberg, and Charles Rossotti are the authors of the STTG plan. We are private citizens who previously served in leadership positions in the IRS. Most of our work before and after our government service has been in private business.

We began drafting proposals on how to shrink the tax gap because, regardless of what else we as a country do about taxes and the deficit, we believe we should at least do what we reasonably can to collect taxes that are due under the tax code but are not being paid. That unpaid tax is called the tax gap, and it is a long-standing subject of conversation in the tax world, but at this time we believe there is much more that we can do.

Size of the Tax Gap

Here is a chart just to remind us how big this tax gap is on a comparative basis.



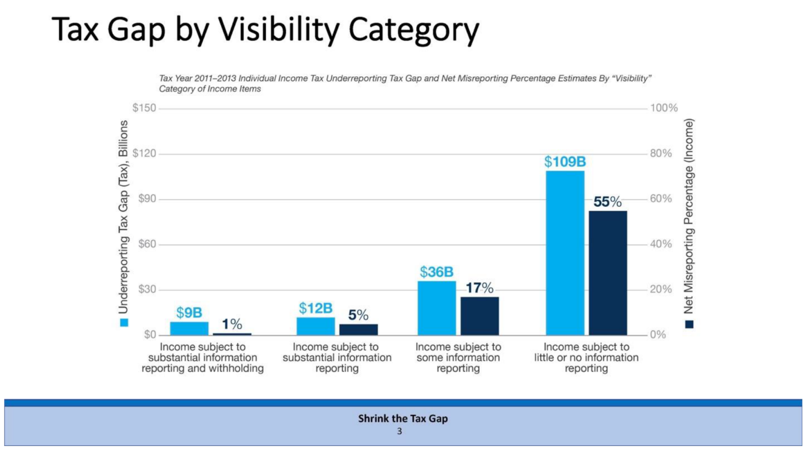
It is more than all the income taxes paid by about 90 percent, meaning about 135 million, individual taxpayers.

It is 87 percent of what the government spent on all domestic programs (before COVID).

The tax gap is not only very large, but also growing every year so it will accumulate to about $7.5 trillion over 10 years if nothing more is done to address it.

Driver of the Tax Gap—Visibility of Income

The tax gap is largely driven by opportunity to underpay. Where there is little opportunity, because income is fully reported by third parties, such as on W–2s or 1099s, and can be efficiently checked by the IRS, there is little underpayment. Where income is less visible and harder to check, there is more opportunity and more underpayment.



This chart from the last IRS compliance study makes that point clearly.

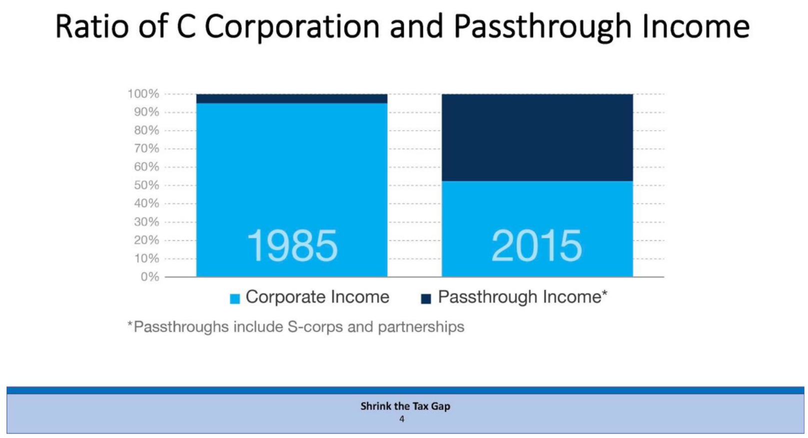
The sources of income that are highly visible and easily checked are on the left of the chart. At least 95 percent of these sources of income are reported on tax returns. Where income is less visible because there is little or no third-party reporting, as on the right of the chart, only about half is reported.

At least 85 percent of that low visibility income is earned by the top 25 percent of taxpayers, so that quartile of taxpayers also accounts for most of the underpayment.

This top quartile of taxpayers also accounts for most of the income, over 95 percent, reported by businesses organized as pass-through entities, S corporations, and partnerships. These businesses do not pay tax directly but pass the income onto their owners. This category of businesses comprises another large category of low-visibility income.

Growth of Pass-through Business Income

Pass-through business income has been growing steadily for 35 years to the point that it now produces almost as much income as corporations that pay tax directly (known as C corporations).



Today there are about 7 million pass-through businesses with about $2 trillion in reported income. They exist in a tax limbo, because there is very limited third-party reporting of their income at the business entity level and negligible IRS examination activity to verify it. Fewer than one-tenth of 1 percent of these businesses are audited.

An IRS study of one part of this universe of pass-through businesses indicated that their underreporting level was like that of sole proprietors for businesses up to a certain size. Another study by a group of economists using IRS data found that as much as 30 percent of partnership income could not be traced to any identifiable ultimate owners. Another important study by the National Bureau of Economic Research which came out recently concluded that unreported income in the top 1 percent of the income distribution is much greater than previously estimated and much of that income is buried in pass-through entities.

Continued Growth of the Tax Gap

The biggest part of the tax gap is driven by low visibility business income earned by the top income quartile of individuals, including in the pass-through businesses they own. The losses from this source have been growing every year and have largely not been addressed in any significant way. The opposite has happened, because over the last 25 years IRS enforcement resources have been cut 30 percent while the number of business returns have grown 80 percent.

The only reason the tax gap is not even bigger is because most taxpayers have no meaningful opportunity to underreport since their income is in a highly visible form that is reported by third parties and easily matched to their return. That still leaves a significant minority who have both the opportunity and the willingness to pay less than they owe, producing the ever-growing tax gap. The tax gap is not an even percentage with every taxpayer underpaying by some percent. It is a highly uneven percentage of underpayment based mainly on who is most easily able to underpay, so it is highly concentrated. Therefore, allowing it to continue to grow is very unfair to the vast majority of compliant taxpayers, who will bear all the burden of any tax increases while the non-compliant taxpayers bear little or none.

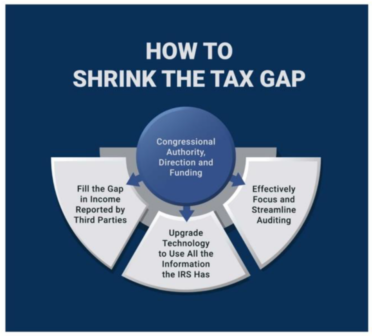
Shrinking the Tax Gap

Right now, the only IRS tool for collecting most underreported income is auditing. While more auditing is an essential part of any solution, auditing alone is not an adequate solution. Today, all IRS audit activity recovers less than 3.0 percent of the tax.

If we want to recover a substantial amount of the tax gap, we need to move more of the income from lower visibility categories to higher visibility categories.

With appropriate authority and funding from Congress, we believe there is a practical way to do this. It consists of three actions that build on what works best in the tax system today.

Shrink the Tax Gap Program (in a nutshell)



Shrink the Tax Gap
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First, we need to fill in the gap in the sources of income reported to the IRS by third parties. Over the last year, in response to many comments, we have refined our STTG plan to make sure it proposes efficiently collecting the bare minimum of information we need and only from taxpayers with income sources and amounts that significantly contribute to the tax gap. (See "Updated Information Reporting Plan" on our website *www.ShrinktheTaxGap.com.*)

Our plan would produce one new 1099 report on low-visibility business income of individual taxpayers in the top quartile of income and the pass-through businesses they own. This 1099 would provide the taxpayer and the IRS a simple annual summary of deposits and withdrawals from their bank accounts. We estimate that slightly more than 13 million individuals and pass-through businesses would receive the 1099New, out of a universe of about 160 million individual and pass-through returns.

Second, we need to make more effective use of technology to use all the information the IRS has but cannot use efficiently, in addition to the 1099New that we propose, to identify likely deficiencies in returns.

Third, we need to transform the auditing process to be the last step in resolving the deficiencies in returns that are identified and analyzed by technology.

It is the combined effect of all three of these elements that will produce a large and efficient reduction in the tax gap. The additional reporting helps the taxpayer file more accurately and provides the IRS the information to check the return efficiently. The technology allows the IRS to use its information to accurately identify likely deficiencies on returns and to increase the efficiency of the follow-up process. The transformed, data-driven audit process will allow the IRS and taxpayers to resolve cases promptly and efficiently.

Gain From Voluntary Compliance

IRS compliance studies universally show that third-party reporting actively used by the IRS for enforcement enormously improves voluntary compliance. Taxpayers who underreport income do so for many reasons, ranging from simple errors to sloppy bookkeeping, a belief that a little corner-cutting is not so bad, overly favorable interpretations of code provisions and outright evasion. More complete third-party reporting that is known to be effectively used by the IRS can positively affect all these factors. The desired and important result is simply to increase compliance without needing IRS intervention.

We estimate that about 68 percent of the revenue gain from our STTG plan would come from improved voluntary compliance. We believe this is a conservative estimate because it is a much lower ratio of voluntary versus enforced compliance than the tax system produces today for income with effective information reporting. Almost all taxes paid on income with high visibility from third-party reporting (over 98 percent) is paid without intervention by the IRS.

Streamlined Follow-up on Identified Deficiencies

Most of our estimated gain that requires intervention by the IRS comes from an enhanced matching and streamlined auditing process supplemented by some traditional auditing. Better use of data and technology greatly improves the follow-up process by more effective targeting and increased case productivity. You can see that difference clearly in this chart.

Return on Investment (ROI) for Major IRS Enforcement Programs *($ in millions)*

Enforcement Program	Cost	2018 Revenue	ROI
Examination	$3,716	$15,017	4.0
Automated Underreporter (Data Matching)	$208	$5,364	25.8

Source: IRS FY2020 Budget and Performance Plan

Shrink the Tax Gap
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By the IRS calculation, traditional audit cases produce revenue equal to four times the cost, while data-driven matching programs like the AUR matching process produce 25 times. They are not perfect comparisons to our STTG plan, but the key point is valid: an entirely manual audit is far less efficient than a process that starts with data that can be analyzed with technology before handing it off to an employee.

The GAO reported in 2018 that the IRS Return Review Program, which uses modern technology to analyze all relevant information to screen returns for incorrect or fraudulent refund claims, had a revenue return of 15 times its cost.[1] The report recommended that approach be used on a broader basis to detect underreported income. That recommendation is exactly what the STTG plan is designed to do.

Unfortunately, even the current IRS data-driven programs, while efficient, are limited not only by lack of data in some areas but lack of sufficient current technology to make use of the data. That is why the technology component of our plan is critical.

GAO reported that the IRS could only process about 15 percent of the cases in which mismatches were identified. Some third-party data, such as 40 million K–1s reporting income from pass-through businesses, are only matched manually as part of an audit. Reports provided under FATCA by foreign financial institutions cannot currently be matched to taxpayer returns. And new technology would be needed to use the 1099New data we recommend and to make the follow-up auditing process more efficient for the IRS and the taxpayer.

Quality of Service and Taxpayer Rights

Assisting taxpayers to comply with the law and treating taxpayer fairly evenly when there is a dispute is a critical component of any program to achieve maximum overall tax compliance. Maximum voluntary compliance is the goal, and the easier it is for taxpayers to comply the more likely it is to achieve this goal.

[1] Government Accountability Office, GAO–18–544, July 2018. "IRS reported that between January 2015 and November 2017, RRP prevented the issuance of more than $6.51 billion in invalid refunds. As of March 30, 2018, IRS reports spending about $419 million developing and operating RRP."

Quality of Service

The technology we propose for our STTG plan would improve the quality of service to taxpayers in two ways that are most important to taxpayers: *prompt and efficient resolution of issues and avoidance of unnecessary audits.*

The technology and process improvements in our plan will allow taxpayers and the IRS to resolve any issues that are identified in a return more efficiently for the taxpayer and the IRS. Today, even a simple examination (called a correspondence exam) is often initiated by a letter from the IRS that is not clear or specific as to the issue or how to resolve the issue. Even these simple cases typically take more than 6 months to resolve. In addition, lack of adequate staffing and inadequate tools for employees often make it very slow or difficult to reach an employee who can resolve a case, even when the taxpayer wants to comply. The technology-supported STTG plan we propose will make IRS letters clearer, provide for a wider range of ways for IRS employees to communicate with taxpayers, and provide the IRS employees better tools to resolve cases. The increased staffing resources called for in our plan will provide for an adequate number of trained employees to resolve taxpayer issues promptly.

A second improvement for taxpayers in our plan will be to reduce the number of so-called false positive audits, namely audits in which no deficiency is actually found. Such audits are unnecessary and costly to the taxpayers and the IRS, and today can be as high as 20 percent for individuals and even higher for businesses. These ratios might be even higher if cases where only immaterial amounts of deficiencies were counted. Proposed technology under our STTG plan would provide a much more effective and accurate way of identifying returns and issues on returns that need follow-up auditing. In addition, a part of our plan calls for the IRS to provide taxpayers a reconciliation schedule that can be attached to their return. This schedule allows taxpayers to explain in advance any differences between the amounts on information reports and those on their return, just as it does today for taxpayers with capital gains reported on a 1099B. This schedule would aid the taxpayer in filing an accurate return and in most cases should make an audit unnecessary. Audits of any kind are expensive for the IRS and the taxpayer, and reducing unnecessary ones is a key way to improve the burden of tax compliance on compliant taxpayers.

These service improvements are solutions to problems the taxpayer advocate has highlighted many times in her reports.

Taxpayer Rights

Taxpayer rights are protections that all taxpayers are entitled to and are mandatory for the IRS to observe whenever the IRS exercises its authority to audit a return or to propose a deficiency. As part of the STTG plan, taxpayer rights should be fully observed and where necessary clarified by law or regulation. Some of the most important rights that are relevant to our plan are:

Issue Resolution Process. No taxpayer should ever be presented with a notice asserting a deficiency in tax without a prompt opportunity to communicate with a qualified IRS employee who can explain the basis for the asserted deficiency and how it can be resolved. This is the intent of all the Shrink the Tax Gap proposals and is implicit in the service goals we propose. This commitment could be further clarified by law or regulation.

Appeal Rights. Right of appeal of an asserted deficiency to the IRS independent Appeals Office (recently strengthened by the Taxpayer First Act).

Burden of Proof on Assessments. Although courts have held that the IRS has the burden of proof in making a deficiency assessment based solely on third-party reporting, this rule should be mandated for internal IRS practice. To ensure implementation of this right, the IRS should provide taxpayers a process for identifying errors on information return.

Recovery of Attorney's Fees. Clarify Eligibility for Small Business Taxpayers to Recover Attorney's Fee and increase limits on fees.

Access to Tax Court. Assure that taxpayer have access to tax court before paying assessments by allowing tax court power to accept jurisdiction on equitable grounds and include cases of penalties assessed by the IRS in the tax court jurisdiction.

Self-employed Access to VITA sites. Expand the jurisdiction of Federal funded VITA sites to assist self-employed individuals.

Revenue Gain

This chart shows our estimate of what our proposed approach could produce if it had been implemented starting in 2020 and how much it would cost in the IRS budget.

Shrink the Tax Gap

Summary of Revenue and Cost Estimates *($ in billions)*

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	10-year Total
Revenue Impact											
Unmitigated Tax Gap	602	631	661	693	731	763	815	866	897	935	7,593
Revenue Gain	32	65	89	111	131	149	171	199	219	243	1,408
Revenue Gain as % of Unmitigated Tax Gap	5%	10%	14%	16%	18%	20%	21%	23%	24%	26%	19%
Cost Impact											
IRS Base Budget	12.6	12.9	13.1	13.4	13.7	13.9	14.2	14.5	14.8	15.1	138.3
Total Cost Increment	0.7	1.8	2.8	4.0	5.4	6.9	8.9	10.1	11.5	11.7	63.8

(If proposal had become effective January 1, 2020)

Shrink the Tax Gap
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We did not start with top-down numbers. Rather, with help from an expert revenue estimator, we estimated how much we could gain by moving the two lowest visibility categories of income to the next higher category source of income. All our calculations are shown in detail on our website *(www.ShrinktheTaxGap.com)*.

Our estimate of the gain, although a large number ($1.4 trillion), still only recovers 19 percent of the tax gap over 10 years. The gain builds gradually in our estimate, because we have been realistic about how fast the IRS could implement what we propose. Our recommended plan is a long-term investment, not a quick fix, but the gain would continue to build year after year as shown see in the chart.

Government Actions Required for Success of Shrink the Tax Gap Plan

1. Clear authority and direction from Congress set in the law.
2. Dedicated, high-level, and ongoing management program within the IRS.
3. Consistent funding increases of about 6 percent per year (in addition to amounts to sustain IRS operations).

Shrink the Tax Gap
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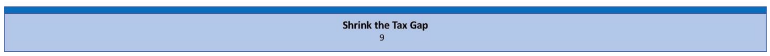
To make our STTG plan successful, we believe it would take three major actions by our Federal Government.

1. Clear authority and a mandate from Congress set in the law is essential to provide a long-term commitment. Specific compliance and service goals, monitored by regular reports of milestones and metrics, can provide the basis for effective oversight and assure taxpayer rights. Our paper, “Goals, Metrics, Taxpayer Rights, and Oversight,” provides details of how this could be done.
2. A dedicated, high-level, ongoing management program within the IRS will be required. In our *Tax Notes* article published on September 11, 2020, we have described how the IRS could successfully implement this plan.
3. Steady, assured funding is essential because the program requires investments in technology and staff that must be planned and executed over time. We estimate that additional funding on the order of 6 percent per year for 10 years is required for implementation of the STTG plan. (This is in addition to that required to sustain IRS ongoing operations, restore adequate filing season services, and modernize legacy systems.)

Summary

- We have a plan to shrink the tax gap by $1.4 trillion ove 10 years.
- This gain is only 19 percent of the total 10-year tax gap.
- The plan includes three actions that work together:
  - Fill the gap in income reported by third parties.
  - Use modern technology to use all the information the IRS has and improve service.
  - Scale up and transform auditing to be the last step in resolving cases identified by technology.



See our website *(www.shrinkthetaxgap.com)* for more details on our plan, including the basis for revenue and cost estimates.

SHRINK THE TAX GAP INFORMATION REPORTING PLAN

Revised Criteria and Process for Financial Service Provider Information Reporting of Low-Visibility Income (1099New), Revised April 15, 2021

Summary

A key part of our proposal to Shrink the Tax Gap is a new information report (1099New) to be provided by financial service providers (FSPs) on accounts held by taxpayers with low visibility income. This update simplifies the proposed process for individual taxpayers by limiting the report to taxpayers who have *both* adjusted gross income (AGI) over a set amount *and* low-visibility income. It also eliminates the need for taxpayers to notify their financial service providers that their accounts should be reported as the IRS will notify the financial institutions directly of which accounts to report. An earlier version of the proposal indicated that taxpayers would need to notify their financial institutions.

Previous Proposal

The following excerpt from our September 14, 2020 article in *Tax Notes Federal,* entitled "Recover $1.6 Trillion, Modernize Tax Compliance and Assistance, the How To," summarized the previous proposal:

> Taxpayers who have only income that's already reported to the IRS by employers, financial institutions or customers (on documents such as the familiar W–2 or 1099) wouldn't have to do anything except check a box on their return.
>
> **A. TCAM[2] Reporting Proposal**
>
> Taxpayers with more than $25,000 of business income would be required to list the account numbers of all their financial institution accounts on their returns. They would notify their financial institutions of the accounts they listed on their returns.
>
> The financial institutions that were notified by taxpayers would provide the taxpayer and the IRS a new 1099 summary report of total deposits received and total withdrawals made in each of these accounts.
>
> The taxpayer would attach a new schedule to their tax return, reconciling the total amounts reported on the financial institution reports to the income and expenses reported on the tax return. For example, if the cash received in the financial institution accounts was greater than the income reported on the return, the schedule would itemize and explain the differences.
>
> More details on the TCAM proposed financial institution and taxpayer reporting is provided in Appendix E, Taxpayer Burden Estimate, on our website *TCAmodernization.com* (Rossotti/Forman 1366).

Updated Proposal

As a result of comments and suggestions from reviewers of our previous article, we decided to change the criteria and process for producing the 1099New informa-

[2] At the time the September 14th *Tax Notes Federal* article was published, we referred to the current Shrink the Tax Gap proposal as Tax Compliance and Assistance Modernization, TCAM.

tion report. We have continued to refine this process as we receive comments and suggestions. The content and use of the report itself would be the same.

Individual Filers

The report would be required for individual taxpayers whose income was in the top 25 percent of all filers and who had income from low visibility sources.[3] Using these criteria, the 1099New report would be provided for about 5 percent of all individual filers and about 20 percent of those with sole proprietor income.

Pass-through Entities

The report would also be required for all pass-through entities who had an ownership interest held by the individual taxpayers above the designated income level.

Process

The IRS would be responsible for determining which taxpayers (individual filers and pass-through entities) would be covered by the 1099New reporting requirement. The IRS would analyze all individual and pass-through returns filed in the previous tax year, determining which returns qualified for the information reporting based on AGI limit, presence of low visibility income and ownership interest in pass-through entities.

Treasury regulations would specify the types of accounts and financial service providers that are covered by the reporting requirement.

A. The IRS would provide the financial service providers limited access to an encrypted file of the taxpayer ID numbers (SSN or EIN) designated to receive the 1099New report.

B. The financial service providers would provide the designated taxpayers and the IRS a 1099New report for all the identified accounts the following year in the same manner as for all other 1099s.

The 1099New rules would apply to financial service providers, which we suggest include:

- Banks and traditional financial institutions that enable individuals to make and receive payments and hold balances.
- Online payment systems and mobile payment apps that permit individuals and companies to make and receive payments and hold a balance that is not always reflected in the traditional banking system.
- Cryptocurrency exchanges.

These rules would cover both FDIC-insured institutions as well as financial service providers not covered by the FDIC. We believe that this definition provides a level playing field and helps accomplish our goal of identifying low-visibility income by covering not only the traditional ways that individuals and businesses execute financial transactions but also the new, technology-driven payment mechanisms that will only become more common in the future.

This process would apply to U.S.-based financial service providers, including U.S. subsidiaries of foreign financial institutions. The IRS already obtains information on accounts in non-U.S. foreign financial institutions under the Foreign Accounts Tax Compliance Act (FATCA) and would make use of this FATCA information in its compliance program.

Taxpayers who receive the 1099New would use the information return in the same way as all taxpayers use 1099s (such as for securities transactions or interest income), to assist in filing an accurate return. The IRS would provide taxpayers a reconciliation schedule that would allow taxpayers to reconcile the 1099News with their return, just as the IRS provides a supplementary schedule (Form 8949) that allows taxpayers with capital gains to reconcile their tax return with amounts reported on the 1099B information return.[4]

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[3] In our analysis we used Adjusted Gross Income (AGI) as an indicator of individual income because IRS statistics are most readily available using this definition. However, we recommend allowing the IRS flexibility as to the precise definition of income it would use to identify taxpayers who would receive the 1099NEW. For example, the IRS sometimes uses a definition of business income that adds back loses to reported income because returns that report high positive income offset by losses often have significant non-compliance issues.

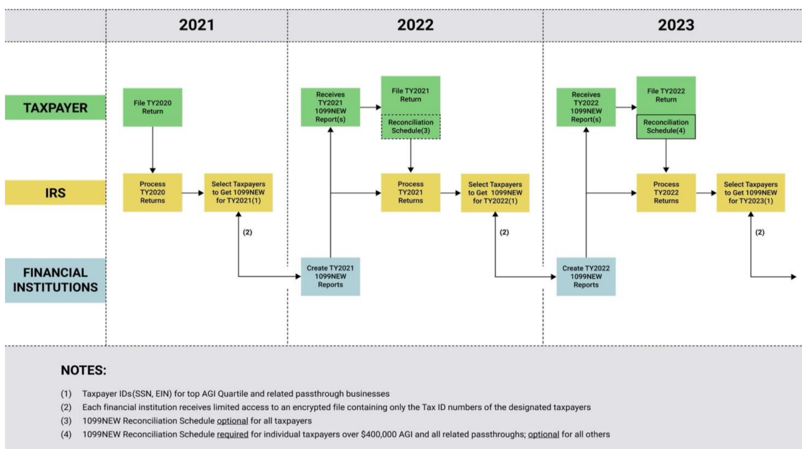
[4] IRS instructions to Form 8949 explain its purpose as follows: "Form 8949 allows you and the IRS to reconcile amounts that were reported to you and the IRS on Forms 1099–B or 1099–S (or substitute statements) with the amounts you report on your return."

This schedule is explained in detail in Appendix E on our website *https://www.shrinkthetaxgap.com/*. As discussed in the section titled “How Much of a Burden Would This Be” in our September 14, 2020 *Tax Notes Federal* article, this schedule would benefit both the taxpayer and the IRS by explaining in advance any potential discrepancies, thereby reducing the likelihood of unnecessary follow-up audits. Unnecessary audits, those in which no change or a trivial change in the tax liability is the result, is a serious source of frustration for taxpayers and inefficiency for the IRS.

The reconciliation schedule would be optional for all taxpayers and would be required after a 1-year delay for individual taxpayers with AGI over $400,000 and all related pass-through entities.

The following figure (also in Exhibit 14 on our website) shows how this new information flow would be implemented over a 3-year period:

1099NEW Information Report Timeline



We have constructed several scenarios to illustrate how the 1099New information reporting and reconciliation schedule would apply to taxpayers in typical situations. These are shown in Exhibit 15 on our website.

Considerations Affecting This Proposed Method

Any additional information reporting will impose some requirements on some taxpayers and on the reporting entities and will involve the exchange of personal financial information between the reporting entities and the IRS. Our goal has been to obtain the required information in a method that, taken as a whole, balances three key considerations:

- Provides the new information reports to the universe of taxpayers who have the predominant amounts of underreported income while avoiding unnecessary reporting on other taxpayers.
- Minimizes the taxpayer information exchanged to and from the reporting entities and ensures the protection of any information exchanged.
- Provides reliable information to the IRS that can be used effectively to shrink the tax gap.

An important fact in weighing these considerations is that the IRS needs the new information report on fewer than 10 percent of the universe of individual and business taxpayers, (approximately 13 million individual and pass-through business taxpayers out of a universe of about 160 million) but it does need as complete a view as possible of the accounts of those taxpayers who do receive the reports. Reporting which omits a significant fraction of a taxpayer's financial accounts is not useful for the IRS and could mislead taxpayers receiving the partial information.

A more traditional method of producing 1099s would delegate to financial services providers the role of selecting which taxpayers would receive the 1099s based on such criteria as the dollar value or dollar inflow to an account. Because the need for information in the STTG plan is limited to a relatively small subset of taxpayers, any such general method would provide information reporting on many more taxpayers than required, while failing to produce complete information on those taxpayers whose income is not otherwise reported. Our proposed method will reliably provide the additional information reporting to only those taxpayers whose income is not otherwise reported, thereby minimizing any overreporting or confusion on other taxpayers.

Privacy and Security Safeguards

The information provided by the IRS to the financial service providers specified in Treasury regulations in order to designate which taxpayer accounts should receive the 1099New would be subject to legal and technology-based safeguards to protect against any misuse of this information. Some of the safeguards would be the following:

- Financial service providers receiving access to the information are all entities that receive and maintain large quantities of sensitive information as a part of their basic operations. They are subject to oversight and compliance checks on their processes to safeguard this information.
- The information provided by the IRS would be provided under regulations specifying that the information could only be used for the purpose of designating accounts to receive the specified 1099New and for no other purpose.
- The information provided by the IRS would contain no financial information, only the bare minimum needed to identify the designated accounts.
- The computer file containing the IRS information would be retained under the control of the IRS at all times. Each financial institution would receive limited, controlled and secure access to this file for a limited time needed solely to identify which of its accounts are designated to receive the 1099New.
- Each financial institution would only be able access the IRS information to identify which of its own accounts were designated to receive the 1099New. It would not have access to any information at all on accounts held at other financial institutions.
- All access to the IRS information would be tracked and logged.

Technical details on the method of by which financial institutions would access the necessary information is provided in Appendix F.

Financial Results With Revised Information Reporting Criteria

Our methodology for making our revenue estimates is explained in Appendix A, *Calculating the Revenue Impact,* and in Exhibits 1, 3, and 4, on our website.

The revised criteria for defining which taxpayers receive the 1099New information report would change our estimate of the revenue gain from our initial proposal because only taxpayers with more than the designated AGI would receive the report, even if they had significant low visibility income below the AGI threshold. Taxpayers with income below this threshold would of course still be legally required to report all their income and would be subject to traditional enforcement procedures, but the IRS efficiency in enforcing compliance would be reduced.

By setting the threshold at an AGI level equal to the top 25 percent of individual taxpayers, we believe we would cover approximately 62 percent of underreported low visibility income on individual returns, while minimizing the number of information reports. We also estimate that requiring the 1099New report for pass-throughs for entities with an ownership interest held by the top 25 percent of individual taxpayers would cover approximately 97 percent of income from pass-through entities. (See Exhibit 12, Backup for Information Reporting, on our website.)

Using these criteria, the estimated revenue gain over 10 years from individual taxpayers would be reduced by about $180 billion, from $929 billion to $749 billion. The calculations for this estimate are shown in our revised Exhibit 3–1, Tax Gap Gain from Individual Taxpayers, Adjusted for AGI Class, on our website.

We also analyzed the effect of this change in reporting on the estimated gain from pass-through entities, as detailed in Exhibit 4–1, Tax Gap Gain from Pass-throughs, Update One, on our website. We concluded that there is no need to change the original estimate of the gain, since about 97 percent of the income of pass-throughs is earned by the top 25 percent of individual taxpayers.

In addition, our initial analysis did not include any gain from pass-throughs with gross receipts over $25 million because we assumed that these large pass-throughs were all technically compliant. On further analysis, by extrapolation from the prior IRS study of S corporations, we concluded that some gain, amounting to approximately six-tenths of 1 percent of income, would be found by the additional reporting on these large pass-throughs.

Finally, we did not include any estimated gain from the application of our technology-enhanced matching process for partnerships owned by other partnerships (so-called tiered partnerships), although prior studies have indicated that as much as 30 percent of partnership income is not traceable to any taxable return.[5] The technology we propose would be capable of identifying where this missing income is going.

We did not assume any change in the estimated cost for the IRS to execute our proposed program.

The technology program would be unchanged except for a minor change in how the 1099New report would be obtained from financial institutions. The new method would actually be simpler for the taxpayer and the IRS.

With respect to IRS staffing, there would be somewhat fewer matching cases under the new criteria for information reporting because a smaller fraction of individual taxpayers would receive the 1099New report. However, we did not assume any reduced staffing requirement because we assume some staffing would be required to perform selective audits on taxpayers below the threshold for receiving the 1099New.

The net effect of these assumptions is to slightly reduce the estimated revenue gain and the estimated efficiency of the overall plan. The overall result of the proposal using the revised reporting criteria is as follows:

[5] Cooper, Michael et al., "Business in the United States: Who Owns it and How Much Tax They Pay." *Tax Policy and the Economy, Number 30,* The University of Chicago Press. © 2016 by the National Bureau of Economic Research.

$ in billions

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	10-year total
IRS Base Budget	$12.3	$12.6	$12.9	$13.1	$13.4	$13.7	$13.9	$14.2	$14.5	$14.8	$15.1	$138.3
Technology Cost Increment		0.1	0.4	0.5	0.7	0.9	1.3	1.7	2.0	2.2	2.3	12.0
Staffing Cost Increment		0.6	1.4	2.3	3.3	4.4	5.6	7.2	8.2	9.4	9.4	51.8
Total Cost Increment		0.7	1.8	2.8	4.0	5.4	6.9	8.9	10.1	11.5	11.7	63.8
Revenue Gain		32	65	89	111	131	149	171	199	219	243	$1,408
Ratio: Revenue Gain to Cost Increment												22
Unmitigated Tax Gap		602	631	661	693	731	763	815	866	897	935	7,593
Revenue Gain as % of Unmitigated Tax Gap		5%	10%	14%	16%	18%	20%	21%	23%	24%	26%	19%

TAXPAYER IMPACT

Appendix E Version 2: Taxpayer Impact, April 18, 2021

Note: This update replaces an earlier version of Appendix E in its entirety.

Reason for Update

Update 1 to our Shrink the Tax Gap plan updated and narrowed the criteria for which taxpayers would receive the 1099New information report and eliminated the need for taxpayers to notify banks about their accounts. These changes also reduced our estimate of the 10-year revenue gain by approximately $200 billion, because the estimated revenue gain would be limited to the top quartile taxpayers. Because of these changes and other comments received on our original proposal, the method used to estimate taxpayer impact in our original Appendix E is no longer valid and is being replaced by Version 2.

Who Would Receive the 1099New Information Report?

The 1099New information report would be provided only to individual taxpayers who have income in the top quartile (*i.e.,* top 25 percent) of adjusted gross income (AGI) and who have business income not reported on other 1099s. It would also be provided to pass-through businesses that these top quartile taxpayers own.

AGI is a frequently used measure of taxpayer income as it allows for certain deductions in stating income. The cutoff for the top quartile of taxpayers was estimated to be about $92,000 AGI in 2020 and will increase each year. We estimate that approximately 13 million individual and pass-through taxpayers would receive the 1099New, out of a total universe of about 160 million individual and pass-through returns.

The 1099New would show total annual deposits and withdrawals from each of the taxpayer's bank accounts over the course of a calendar year.

Individual and pass-through taxpayers would receive the 1099 from financial institutions that hold their depository accounts as they do all other information reports. They would not have to do anything to receive these reports.

The universe of financial institutions and types of accounts to be reported on would be defined by Treasury regulations and would include not only commercial banks but other financial providers who regularly accept and process financial inflows and transactions.

Reconciliation Schedule

Summary Description. The IRS would provide instructions and a supplementary information schedule that would allow taxpayers to reconcile their total withdrawals and total deposits from the 1099New reports to their business gross income, business deductions, and net income or loss. This schedule would aid the taxpayers and their preparers to prepare an accurate return and would eliminate the need in many cases for the IRS to audit a tax return, thereby saving the taxpayer and the IRS significant time spent in unnecessary audits.

This schedule is similar to the schedule the IRS provides to taxpayers (Form 8949) to allow them to reconcile their capital gains income as reported on the tax return to amounts reported on information returns 1099–B.[6] Form 8949 provides a set of codes allowing the taxpayer to designate amounts that are reported on the 1099B that are not required to be reported as gains on the tax return. That is the same process that would be used on the STTG proposed reconciliation schedule.

Schedule Optional for Most Taxpayers. The filing of the reconciliation schedule would be optional for any individual taxpayers with AGI under $400,000. Taxpayers with AGI over this limit and who receive the 1099New and report the income on their individual returns would be required to file the reconciliation schedule. We estimate that requirement would cover approximately 1 percent of all individual tax returns and about 20 percent of those who receive the 1099New. It would also be required for most pass-through businesses since most of them are owned by top quartile taxpayers.

Personal Accounts Excluded. The reconciliation schedule would provide for taxpayers to designate any bank accounts that did not include business receipts or de-

[6] The instructions to Form 8949 state that "Form 8949 allows you and the IRS to reconcile amounts that were reported to you and the IRS on Forms 1099–B or 1099–S (or substitute statements) with the amounts you report on your return."

ductions as personal accounts and to exclude them from the reconciliation schedule for simplification purposes.

Schedule Details. The reconciliation schedule would allow the taxpayer to identify and explain adjustments to deposits that do not constitute income, such as deposits from non-business income, or loans and adjustments to withdrawals that are not allowable business deductions, such as personal use withdrawals or return of owner capital.

The adjusted amounts of deposits and withdrawals would reconcile to the appropriate line items on the tax return schedule.

A reconciliation schedule would be done for business income (*e.g.,* Schedule C, E, or F) on an individual tax return and at the entity level for pass-through entities.

The data from the 1099New and the process of reconciling it would aid the taxpayer or his preparer in filing an accurate return by checking that all appropriate receipts are included in income and that only appropriate deductions are used.

The reconciliation schedule would only need to cover significant items causing a difference between the 1099New and the return and would not need to balance to the penny. It would not require transaction-level detail, only general categories, such as "non-deductible personal expenses" in reconciling withdrawals, or "gifts" in reconciling deposits. These categories would be similar to the codes provided for in the instructions to the Form 8949 reconciliation schedule. Most taxpayers covered by this requirement are cash-basis taxpayers, but the schedule would also provide for taxpayers who report on an accrual basis.

How the Reconciliation Schedule Would Be Prepared

The providers of tax preparation software would incorporate the 1099New and the related IRS reconciliation schedule into their software. The software would allow the preparer to enter or directly upload the 1099New just as they do for all other 1099s. After the associated tax return schedule (*e.g.,* Form 1040, Schedule C, or Form 1065) was prepared, the software would then prompt for or require adjustments necessary to prepare the reconciliation schedule, which would be filed as part of the tax return.

In order to allow software providers, preparers and taxpayers adequate time to prepare the reconciliation schedule efficiently, for those taxpayers required to file the reconciliation schedule, the requirement would be delayed for one full tax year after the first year in which the taxpayers would receive the first 1099New. This would allow sufficient time for taxpayers who file the schedule to identify any transactions in their records so they could be retrieved and used at the end of the year to prepare the schedule for the following years.

Cost to the Taxpayer

There would be no cost to the taxpayer to receive the 1099New, as it would be provided by the taxpayer's financial institution just as any other 1099. The only additional requirement for the taxpayer would be preparation of the reconciliation schedule to be filed with the return by high income individual taxpayers (those with AGI over $400,000) and for pass-through business entities.

According to the annual survey by National Federal of Independent Business (NFIB), 88 percent of their members use preparers for their returns, and we believe almost all high-income business taxpayers use preparers with automated systems to maintain business records and to do tax return preparation. All bank accounts of pass-through businesses have separate tax ID numbers and we believe that almost all the high-income individual taxpayers who would file the reconciliation schedule would maintain separate accounts for their business activities. Since filing the reconciliation schedule would be delayed for a full tax year after first receiving the 1099New, preparers would be able to identify any transactions in their systems of record that would be required to prepare the schedule. Taxpayers could also take advantage of this delay to reconfigure their bank accounts to simplify the process.

Based on published surveys and informal discussions with software providers and preparers, we are working on estimating how much the reconciliation schedule would increase the cost of preparing a business return. We do not yet have this data but will publish it if we can get reliable data.

Whatever the cost to the taxpayer, preparation of business tax returns is a deductible business expense.

Direction and High-Level Goals Set by Congress

Shrink the Tax Gap is a long-term program involving major change in how the IRS does business and how it interacts with taxpayers. It encompasses increased information reporting, investment in modern technology, and modernized enforcement processes. From Congress, these changes will require clear direction and goals, sustained long-term funding, and continuing oversight. The IRS in turn will have to provide data to measure progress and to provide a basis for oversight.

This paper shows how goals and measurements of progress for the program could be articulated and used for oversight by the administration and congressional committees.

A Successful Example: Electronic Filing

An example of how the goals for the Shrink the Tax Gap program could be stated is the IRS Restructuring and Reform Act of 1998. This law was passed after a year of study of the IRS by a bipartisan congressional panel. It prescribed and authorized many significant changes, including a key one requiring the IRS to convert to electronic filing of tax returns, set in the law as follows:

> (a) IN GENERAL—It is the policy of Congress that—(1) paperless filing should be the preferred and most convenient means of filing Federal tax and information returns; (2) it should be the goal of the Internal Revenue Service to have at least 80 percent of all such returns filed electronically by the year 2007; and (3) the Internal Revenue Service should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of returns.

At the time this law was passed, electronic filing at an early stage, but today the tax system could not function without it. The program required major behavioral change by taxpayers and technological change in the IRS and had to overcome many obstacles over the subsequent 20 years. A key element in allowing it to succeed was the clear mandate and direction set in law.

The goal stated in the legislation of 80 percent electronic filing seemed clearer than it actually was and required more definition by the IRS to make it operational. These more specific metrics were developed by the IRS following guidance from hearings and studies that both preceded and followed the legislation.

Through all the challenges and changes, the clear mandate in the law provided the direction the IRS needed to continue making progress.

Congressional Direction and High-Level Goals for the STTG Program

Following the pattern set in the Restructuring and Reform Act of 1998, we suggest formulating the IRS mandate for the STTG program in a form such as:

"It is the policy of Congress that—

1. Compliance
    a. Goal. It should be the goal of the IRS that, by the 10th tax year after the effective date of this statute, the net tax gap, as measured by the fraction of taxes due that are not reported and paid, should be reduced by at least 20 percent, as compared with the fraction estimated in the most recent IRS study prior to enactment of this statute.
    b. Priorities. Priorities for actions and resources to improve compliance should be guided by the relative dollar amounts of non-compliance.
2. Service
    Goal. It should be the goal of the IRS that the quality, timeliness and accuracy of assistance provided to taxpayers interacting with the IRS be comparable to that provided by leading private financial services institutions.
3. Reporting
    a. Within 1 year of enactment, the IRS will prepare a plan to achieve the compliance and assistance goals and will define milestones and metrics indicating progress on achieving the goals. Milestones and metrics must be reported at least annually indicating progress in executing the plan.
    b. In addition to reporting annual milestones and metrics, within 3 years after the effective date of this statute and every 2 years thereafter, the IRS shall present a comprehensive quantitative and qualitative report

evaluating progress towards these goals and reporting changes to the overall plan."

Compliance Goal. A formulation in this manner would ensure that the IRS would seek to steadily reduce the tax gap and improve assistance to taxpayers, but also would focus its highest priority on taxpayers that are responsible for the largest dollar amounts in the tax gap. The compliance goal is largely independent of fluctuations in the level of revenue collections because it is defined as improvement in the fraction of taxes due that are paid rather than any absolute amount. As shown in past IRS compliance studies, this fraction has remained relatively stable over time in the absence of effective IRS actions to reduce it.[7]

Service Goal and Taxpayer Rights. Although we call the program Shrink the Tax Gap (STTG), our proposed improvements in IRS's business processes and technology would also improve the taxpayer experience in all aspects of their dealings with the IRS. The taxpayer experience encompasses two aspects taxpayer service and taxpayer rights. Both are essential to achieving voluntary compliance and fairness to all taxpayers.

A high quality of service whenever a taxpayer interacts with the IRS is essential so that taxpayers who are trying to comply can do so efficiently and without undue time or stress. For this reason, we include a service goal on par with the compliance goal. Taxpayer rights are a mandatory aspect of the IRS dealings with the public whenever it asserts its authority to enforce compliance.

To support the improvement in taxpayer experience and ensure adherence to taxpayer rights in the compliance process, approximately 24 percent of the STTG estimated staffing costs are allocated to taxpayer education, prefiling service support and taxpayer rights function such as appeals and taxpayer advocate.

Reporting and Oversight. Clear and consistent reporting is essential to effective oversight by both the executive branch and congressional oversight committees. This requirement will be aided by defining and incorporating an appropriate reporting process into the IRS mandate.

Once a clear mandate and direction such as suggested above is set into law, the IRS will propose specific programs and resources to accomplish the goals, including defining appropriate milestones and metrics to indicate progress. This framework would enable both Congress and Treasury to perform their critical oversight function. The following discussion shows how these milestones and performance metrics could be defined. This discussion focuses on measurements that would be newly developed or updated to be relevant to the goals of the STTG program.

In considering the specific milestones and performance metrics we recommend, we want to emphasize four points:

1. This kind of change cannot happen overnight. Successful implementation will require long-term funding commitments and consistency in much-needed congressional and executive branch oversight.
2. While modernized enforcement strategies including increased audit coverage will be necessary, the primary driver of shrinking the tax gap will be the improved voluntary compliance that flows from enhanced information reporting supported by modernized technology. Approximately 68 percent of our estimated revenue gain is from voluntary compliance.
3. Meeting industry standard service levels an essential element of improving compliance and one that can and should be implemented on a far more rapid time.
4. Since the STTG program focuses on reducing underreporting of income, it important for taxpayer rights related to this aspect of the IRS process be clarified and fully monitored. (This is discussed more fully below.)

[7] In four IRS compliance studies in time periods from 2001 to 2013, the voluntary compliance rate varied in a very small range, a maximum of 1.3 percent. *See* Figure 2 in Internal Revenue Service (IRS) Research, Applied Analytics and Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013,* Publication 1415 (Rev. 9–2019), Washington, DC. This ratio is driven primarily by the level of information reporting and IRS follow-up on identified deficiencies, both of which were relatively constant in that period. This is what STTG aims to change.

Milestones and Performance Metrics

The reported data should fall broadly into two categories: Milestones and Performance Metrics.

Milestones

Milestones reflect a point in the STTG program when a specific improvement in IRS operations or services has been achieved and that indicates progress in implementing the overall plan. An example of an early milestone would be for the IRS to implement the procedures to exchange information with banks needed for the 1099New and to receive the 1099New. A high-level list of possible milestones for the proposed compliance plan is as follows:

Business Process Milestones

Date	Milestone	
≥ 3 months before Year-1	A	Congress Passes STTG Program Enabling Legislation
January Year-1	B	STTG Program Start; Program Planning Phase
July Year-1	C	Start Selected Workstreams; Taxpayers Begin Notification to Banks of Business Accounts
January Year-2	D	First Filing Season Accepting New Bank Information Returns and Reconciliation Schedule
July Year-2	E	Select Initial Business Returns for Traditional Examination
July Year-3	F	Initial Return Analysis Model Trained Using Business Returns (subsequent models trained every six months)
July Year-3	G	STTG Accepts First Business Returns for Matching Analysis Using Initial Analytical Models
July Year-4	H	STTG Accepts First Business Returns for E-Exam Analysis Using Initial Analytical Models
July Year-5	I	STTG Accepts First Business Returns for Field Exam Analysis Using Initial Analytical Models
January Year-6	J	RRP Converted to STTG Platform for Case Management (with new models)
August Year-7	K	Initial STTG Tax Gap Estimate
August Year-7	L	Multi-Format Searchable Database in Production
February Year-8	M	Legacy AUR System for Matching Sunset Complete
August Year-8	N	Legacy System for Remote Exam Sunset Complete
February Year-9	O	Legacy System for Field Exam Sunset Complete

The STTG planning process would be an essential foundation for the program. An initial plan would be produced by the IRS and updated regularly. At each update, the list of milestones for the near-term years would be expanded, usually including two to three meaningful milestones each year. The milestones would be updated each year to reflect updates to the plan and to add to the near-term list of milestones.

Performance Metrics

Performance metrics are numerical indicators of progress toward the IRS broad compliance and service goals as mandated by Congress.

Compliance Metrics

The major long-term measure of success for the compliance program is the fraction of taxes due that are paid and collected after considering IRS intervention. This is referred to as the Net Compliance Rate (NCR), which is defined by the IRS as follows:

> The net compliance rate (NCR) is defined as the sum of all timely and enforced and late payments divided by total true tax, expressed as a percentage.[8]

In the last full IRS study, the NCR was 85.8 percent and the net tax gap percentage was therefore (1–85.8 percent) or 14.2 percent of the total amount of tax legally due. To get to the overall goal of a 20-percent reduction after 10 years, the net tax gap percentage would have to go down from 14.2 percent to 11.4 percent.

While this broad measure is the most meaningful measure of compliance in the tax system in the past it has been available only sporadically after periodic IRS studies. The most recent study concluded in 2013. Furthermore, it is a composite that summarizes a number of sub-elements such as underpayment, underreporting and non-filing for each type of tax (individual income tax, corporate tax, etc.).

The IRS compliance studies also compute a ratio, called the Net Misreporting Percentage, (NMP) which specifically measures the underreporting of different sources of income in the individual income tax, which is the largest component of the tax gap and is the major focus of the STTG program.[9] The NMP is the metric that shows large variations in compliance are driven by the level of information reporting.

Our recommended long-term STTG compliance program would build on these sound measurement concepts but would use them to provide more current and useful compliance metrics on an on-going basis. This would be possible as a by-product of the proposed transformed compliance approach which would use greatly enhanced technology to evaluate every return as it was processed using all available information, including enhanced information reporting and machine learning models.[10] This automated process would usually analyze returns and follow up on issues in the same year they were processed, greatly increasing the timeliness of available data. Some traditional auditing would be needed to train the machine learning models as well as to follow up on certain types of cases. From this large amount of data, rolling samples could be used to track compliance trends at least annually.[11]

Our proposed plan breaks the work of building models and analyzing returns into an estimated 16 return analysis models which would be implemented incrementally over a 10-year period. The actual number of models would be increased or decreased as the IRS gained experience with this approach.

Each of these models would represent a subcategory of underreporting. For example, one model might focus on underreporting of rental income, which is now in the lowest visibility category with a Net Misreporting Percentage (NMP) of 51 percent. Another model would focus on matching K–1s reporting pass-through income to taxable returns, which has an NMP of 11 percent. Each model would include tracking statistics to estimate trends in compliance as measured by the Net Misreporting Percentage, both as filed and after IRS intervention.

The trend in this ratio would provide the basis for measuring progress towards improving compliance (including the effect of both voluntary compliance and enforcement activities).[12] Over time these could be aggregated to estimate overall reductions in the Voluntary Compliance Rate and the Net Compliance Rate for all underreported income for the individual income tax.

While not proposed explicitly as part our STTG plan, a similar approach could be taken by the IRS to measure trends in non-filing compliance.

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[8] Internal Revenue Service (IRS) Research, Applied Analytics and Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013,* Publication 1415 (Rev. 9–2019), Washington, DC.

[9] Our STTG program would also include underreported self-employment tax related to underreported income.

[10] This process is described in detail in *Tax Notes* article, "Recover $1.6 Trillion, Modernize Tax Compliance and Assistance: The How-To," published September 14, 2020, and at *www.shrinkthetaxgap.com,* Appendices B and C.

[11] The IRS is already working on approaches similar to this. In a recent memo, Commissioner Rettig noted, "In an effort to provide more frequent and timely updates, RAAS is actively developing methods to 'forecast' the tax gap in advance of actually reporting compliance data and then revising the estimates as actual data are later collected and analyzed. These new approaches and methodologies designed by RAAS would enhance the currency of future tax gap estimates as well as identify possible additional sources contributing to the tax gap."

[12] Although these ratios would be subject to some estimation error, this error would decrease over time as the IRS processed and sampled more returns in each subcategory from the return analysis process. The IRS would also be able to provide statistical analysis showing the level of significance of changes in the estimates.

In addition, TIGTA and GAO produce reports analyzing compliance levels for certain sensitive categories of taxpayers. These reports provide additional baselines against which the IRS could periodically re-estimate compliance trends in these categories. For example, a recent TIGTA report provided could be used as a baseline of non-filing by high income taxpayers.

In summary, the IRS would produce measurements of the change in the compliance ratios of various subcategories of taxpayer income regularly, beginning approximately 2 years after the start of the program. Broader aggregated measures should be possible approximately 3 years after the start of the program and a full annual tax gap report should be possible after 5 to 6 years.

The critical consideration in the compliance program is to develop performance metrics that align with the major goal, which is to improve overall compliance results with improved voluntary compliance as well as revenue from enforcement actions. We believe the program we recommend can produce performance metrics that are properly aligned with that goal and are reasonably indicative of progress or lack of progress, even if they are partial or imperfect in the early periods.

Another category of performance metrics indicates performance in direct interactions with taxpayers. These are commonly referred to as "customer service" metrics, and they are in many respects comparable to metrics used in commercial businesses, including financial services businesses. They can apply to taxpayer interactions that occur through different channels, such as phone calls, traditional mail, or increasingly through electronic communications. The IRS already produces many of these metrics and reports on them to the public and to Congress.

Compliance-related interactions

Compliance interactions related to underreporting of income are the primary focus of the STTG plan. A fundamental aspect of this plan is to transform the majority of interactions with underreporting taxpayers to a faster and more efficient process of identifying and resolving potential underreporting issues than now occurs in traditional audits. The IRS would have the responsibility to use all the information it already has to analyze returns and identify possible deficiencies before contacting the taxpayer. The interaction with the taxpayer should be faster, more efficient in use of the IRS and the taxpayer's time and focused on resolving any specific issues identified by the process.

Service performance metrics for this process should be broadened to include, for example: (1) the fraction of false positive cases (*i.e.,* cases with no or minimal change in tax); (2) the taxpayer's view of the clarity and quality of notices; (3) quality, timeliness and accuracy of calls and other interactions (as measured by surveys); and (4) the time to resolve cases.

The previous discussion is not a comprehensive specification of all service and assistance metrics but is intended to illustrate the kinds of new or updated metrics the IRS should produce as part of its modernization of business practices and accompanying funding.

Taxpayer Rights

Unlike compliance and service goals for the IRS, taxpayer rights do **not** represent a goal for the IRS. They are a **mandate** that the IRS must adhere to, just as taxpayers are expected to adhere to the law. Many taxpayer rights are already included in law or regulations but many of those relate to the IRS process for collecting amounts known to be owed by the taxpayer. The STTG compliance process is aimed at identifying income not properly reported on tax returns and resolving those likely deficiencies with taxpayers through follow up enforcement processes of various kinds.

We believe that several key taxpayer rights do already apply in these situations but some of these rights may need to be clarified by regulation, and all should be regularly monitored by the independent Treasury Inspector General of Tax Administration (TIGTA).

Some of the most important rights that are relevant to our plan are:

Issue Resolution Process. No taxpayer should ever be presented with a notice asserting a deficiency in tax without a prompt opportunity to communicate with a qualified IRS employee who can explain the basis for the asserted deficiency and how it can be resolved. This is the intent of all the Shrink the Tax Gap proposals and is implicit in the service goals we propose. This commitment could be further clarified by law or regulation.

Appeal Rights. Right of appeal of an asserted deficiency to the IRS independent Appeals Office (recently strengthened by the Taxpayer First Act).

Burden of Proof on Assessments. Although courts have held that the IRS has the burden of proof in making a deficiency assessment based solely on third-party reporting, this rule should be mandated for internal IRS practice. To ensure implementation of this right, the IRS should provide taxpayers a process for identifying errors on information return.

Recovery of Attorney's Fees. Clarify eligibility for small business taxpayers to recover attorney's fees and increase limits on fees.

Access to Tax Court. Assure that taxpayer have access to tax court before paying assessments by allowing tax court power to accept jurisdiction on equitable grounds, and include cases of penalties assessed by the IRS in the tax court jurisdiction.

Self-employed Access to VITA Sites. Expand the jurisdiction of federally funded VITA sites to assist self-employed individuals.

Operations and Financial Metrics

In addition to the items discussed above, the IRS produces many operational statistics and much budget and financial data. This includes data reported internally to manage the agency, to support budget requests and to report periodically to Treasury, OMB and Congress. This data includes project level data on specific modernization projects and other initiatives and would be readily expanded to cover all the STTG programs.

External Indications of Progress

In a recent CBO report on IRS enforcement, CBO suggested an excellent possibility for considering the impact of major IRS programs, stating the following:

> The scorekeeping guidelines do not apply to CBO's baseline budget projections or to its other projections such as the analysis of the President's budget. So, although CBO does not include the revenue effects of changes in the IRS's funding in cost estimates, the agency incorporates both the spending and revenue effects of enacted legislation in its next update of baseline budget projections.[13]

For a program like STTG, which would over time have a material impact on revenue estimates, CBO's ability to incorporate this impact in its regular revenue and budget projections would be extremely valuable. Although it would not necessarily tie precisely to the impact of STTG, it would show revenue trends over time as the program progressed.

Oversight

In a major program such as we recommend, it would be essential for the incumbent administration and congressional committees to conduct regular oversight. Establishing clear goals and a set of regularly reported milestones and metrics as recommended in this paper would provide a baseline for these oversight committees to evaluate progress and make recommendations for changes. The GAO and TIGTA, well established independent reviewers of IRS activities, could use this baseline and these regularly provided metrics, as well as their own audits, to inform the oversight committees.

This approach would ensure that resources were used as intended, that plans were adjusted based on experience, and that the public could be informed of progress.

LEGISLATIVE FINANCIAL ANALYSIS SUMMARY, MARCH 14, 2021

Basis for cost estimates

The Shrink the Tax Gap proposal is for a major long-term program aimed at reducing major sources of underreported income.

We have done considerable analysis to document a plan that includes additional information reporting, a major technology program to make full use of all the information available to the IRS, and a scaled up and modernized matching and auditing program.

[13] Congressional Budget Office (CBO), *Trends in Internal Revenue Service's Funding and Enforcement,* July 2020.

We have estimated in some detail the technology costs and the staffing and support costs to fund this program over a 10-year period. This estimate is fully explained in documents and spreadsheets on our website *shrinkthetaxgap.com.* The details of the methodology for estimating technology costs, staffing costs and overall summary costs are explained in Appendices B, C, and D and the calculations are shown in Exhibits 9, 10, and 11.

These estimates necessarily used certain conventions. One of these conventions is the assumption that the program began on January 1, 2020. We also assumed that all other programs, including modernization of legacy systems, not in scope for the STTG program, would be rolled forward with only an inflationary annual adjustment, assumed to be 2 percent per year.

Adjusting to Fit a Legislative Timetable for Funding

We adjusted our STTG cost estimates to fit an assumed legislative timetable as follows:

- Authorizing legislation passed in calendar 2021
- IRS Planning phase started in fiscal 2022
- IRS STTG program starts in fiscal 2023

The results for the adjusted program are shown in the Exhibit 16, STTG Legislation Financial Analysis along with the assumption used to make the adjustments. The 10-year total costs are as follows:

STTG Technology With Inflation Shifted	$13,373,000
STTG Staffing With Inflation Shifted	$59,253,000
Organizing and Planning	$29,000
Total STTG Funding Request	$73,005,000

Also shown is a summary functional allocation of total projected 10-year costs, which is as follows:

Summary Allocation of Total STTG 10-Year Costs

	Percent of total
Technology Investment	19%
Staffing and support	
Enforcement	62%
Pre-filing education and service	6%
Appeals, Counsel, Taxpayer Advocate	14%
Total for Shrink the Tax Gap Program	100%

What Is Included and Not Included in STTG Program Costs Estimates

The STTG program cost estimates include all costs necessary to develop and implement the STTG program over a 10-year period. This includes technology development and operating costs for all new technology needed to support the STTG program, as well as an allocation for necessary modifications to IRS legacy systems. It also includes staffing costs, for the modernized enforcement program, which consists of:

- Field exams; e-exams, and enhanced matching;
- Staffing costs for pre-filing and customer service related to the STTG information reporting and enforcement programs;
- Staffing for the post enforcement processes of appeals, Counsel and the Taxpayer Advocate and responding to taxpayer and adviser inquiries; and
- An allowance for support costs related to the direct staffing costs.

The STTG cost estimates *do not* include any incremental costs needed for the IRS to provide industry standard customer service in its day-to-day dealings with the vast majority of compliant taxpayers and their advisors. It also does not include costs required for ongoing modernization of IRS legacy systems beyond what is in the IRS base budget, or for supporting newly enacted programs such as the periodic child credit. Funding for some of these items may be included in recently enacted

IRS appropriations. In our estimates, we only assumed a constant IRS base budget increased 2 percent per year for inflation.

Four points worth emphasizing:

1. This kind of change cannot happen over-night; the 10-year funding period is needed to permit effective implementation.
2. In turn, this will require long-term funding commitments and consistency in much-needed congressional and executive branch oversight.
3. The primary driver of shrinking the tax gap will be the improved voluntary compliance from enhanced information reporting, supported by modernized technology and enforcement. Approximately 68 percent of our estimate of the revenue gain is from enhanced voluntary compliance.
4. While not covered by the STTG cost estimates, meeting industry standard service levels for basic tax law and account inquiries is an essential element of improving compliance.

Legislative Financial Analysis Detail

Adjusting the Original Shrink the Tax Gap Proposal the Fit a Revised Legislative Timeline

This spreadsheet presents our best estimate of costs of implementing our Shirnk the Tax Gap Program, including IRS technology investment and IRS staffing increment.
It assumes that legislation authorizing the program would become effective in calendar 2021 and the IRS would implement a small planning phase in FY22, with the principal program beginning in FY 2023
(see notes below for calculation methodology)

Original Data																
		CY2020	CY2021	CY2022	CY2023	CY2024	CY2025	CY2026	CY2027	CY2028	CY2029					Total
Base Budget		12,630	12,883	13,140	13,403	13,671	13,945	14,223	14,508	14,798	15,094					138,295
STTG Technology Investment		64	388	502	657	949	1,289	1,724	1,950	2,153	2,341					12,017
STTG Staffing Increment		641	1,412	2,256	3,350	4,430	5,649	7,150	8,154	9,382	9,382					51,806
Total STTG		705	1,800	2,758	4,007	5,379	6,938	8,874	10,104	11,535	11,723					63,823
Original Shifted 3 Years (except IRS Base Budget)					CY2023	CY2024	CY2025	CY2026	CY2027	CY2028	CY2029	CY2030	CY2031	CY2032		Total
Base Budget					13,403	13,671	13,945	14,223	14,508	14,798	15,094	15,396	15,704	16,018		146,760
STTG Technology Investment					64	388	502	657	949	1,289	1,724	1,950	2,153	2,341		12,017
STTG Staffing Increment					641	1,412	2,256	3,350	4,430	5,649	7,150	8,154	9,382	9,382		51,806
Total STTG					705	1,800	2,758	4,007	5,379	6,938	8,874	10,104	11,535	11,723		63,823
Inflation Factor	0.02		1.020	1.040	1.061	1.082	1.104	1.126	1.149	1.172	1.195	1.219	1.243	1.268		
STTG Technology w/Inflation					68	420	554	740	1,090	1,510	2,060	2,377	2,677	2,969		14,466
STTG Staffing w/Inflation					680	1,528	2,491	3,773	5,089	6,619	8,545	9,940	11,665	11,899		62,228
Total STTG w/Inflation					748	1,948	3,045	4,513	6,179	8,129	10,605	12,317	14,342	14,868		76,694
Shift to FY, Add Planning																
				FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032		Total
STTG Technology w/Inflation Shifted					51	332	521	693	1,003	1,405	1,923	2,298	2,602	2,896		13,723
STTG Staffing w/Inflation Shifted					510	1,316	2,250	3,452	4,760	6,236	8,063	9,591	11,234	11,840		59,253
Organizing & Planning				17	11											29
Total STTG Funding Request				17	572	1,648	2,771	4,146	5,762	7,641	9,986	11,889	13,836	14,736	0	73,005

Calculation Methodology
1. Started with figures from the Sept. 14 Tax Notes article, which were on a calendar year (CY) basis, starting in 2020, with a 6-month planning workstream
2. Moved that to a CY2023 start, incorporating a 2% inflation escalation to expenses; IRS base budget was kept and extended with a 2% annual increase
3. Shifted to a fiscal year (FY) basis for STTG Program costs and added an additional Organizing and Planning task to preceed STTG Program start

REVENUE ESTIMATING METHODOLOGY

Calculating the Revenue Impact, Revision 2, April 7, 2021

Note: All STTG articles, appendices, and exhibits referenced in this Exhibit A, Revision 2, are posted on our website *www.shrinkthetaxgap.com.*

Introduction

This Appendix represents our second revision of the document first published in connection with our *Tax Notes* article on March 2, 2020. The basic methodology is the same, but we made two significant changes. We revised the projected revenue phase-in to be consistent with the more detailed timeline described in Appendix B, in connection with our second *Tax Notes* article published on September 11, 2020. We then further revised the revenue estimate to be consistent with our updated plan for information reporting (see Update 1 on our website). Our revised information reporting plan limits the 1099New to taxpayers with low-visibility income in the top income quartile and related pass-through businesses. This change reduced our overall estimate of the revenue gain over 10 years from about $1.6 trillion to about $1.4 trillion.

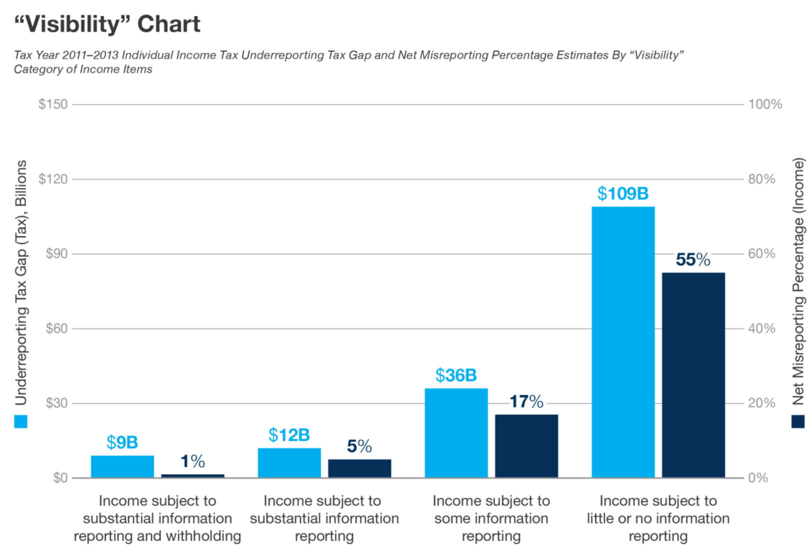
We estimated the revenue gain from implementing the plan using published IRS data and compliance studies. In addition, we used IRS data and other government data to project revenue estimates over a 10-year budget window for the years 2020 through 2029.

This Appendix documents the methodology and the resulting calculations. Each exhibit notes the specific source of the data used in the calculations.

As the author, I am responsible for the estimates. I was ably assisted in these calculations by Michael Udell of the District Economics Group and by other highly qualified experts in tax and advanced technology.

Methodology Summary

It is well established by many IRS studies that the fraction of underreported income is driven by the visibility of the income source as determined by the level of third-party reporting that the IRS can use to follow up. This chart, from the IRS Research, Applied Analytics, and Statistics study titled *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013,* shows this difference clearly.



We made our revenue estimates by calculating how much revenue would be gained if income in the two lowest visibility categories were each improved by one level. The misreporting percentage of income in the lowest category would improve from 55 percent to 17 percent, and the second lowest category would improve from 17 percent to 5 percent.

We made separate calculations for income reported on individual returns and pass-through returns.

We did a detailed estimate of the revenue impact of our plan for one tax year if the improvement had all occurred in that year. We then assumed that this improvement would take a full 10 years to achieve, and we estimated a phase-in over the 10-year period. We applied standard revenue projecting factors to estimate the impact for each year of the 10-year budget period from 2020 through 2029.

Our end result is summarized in Exhibit 1, Projection of Gains from STTG.

Two items are very critical to note about this methodology. One, the revenue gain is the result of a **combined 3-part program** of increased information reporting; improved technology to make use of all the pertinent information (including not only our proposed 1099New but more use of existing information) and finally efficient follow-up on identified deficiencies in returns. This is the process that works today that allows the IRS to efficiently collect 95 to 99 percent of the taxes due in the two highest visibility categories. We are proposing to extend that approach to more sources of income.[14] And, two, even after our projected 10-year period, **our esti-**

[14] The sources of income to which we are increasing the visibility, which are various forms of business income, are more complex than most other sources, which is why we also recommend

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mated gain is still only a cumulative 19 percent of the tax gap over that period. This is true because we are only assuming a relative, not a full, improvement in underreported income, and even that improvement occurs gradually over the period.

The sections below discuss the methodology for each aspect of the calculations, followed by a discussion of the 10-year projections. Each section refers to exhibits which contain spreadsheets and backup data. The list of relevant exhibits, which can be found at www.shrinkthetaxgap.com, is as follows:

1. Projection of Gains from STTG;
2. Tax Gap Projection to 2019;
3. Tax Gap: Calculation of Gain From Individuals; and
4. Tax Gap: Calculation of Gain From Mid-sized Pass-throughs.

Reduction in Tax Gap From Additional Third-Party Reporting, Taxpayer Reconciliation Schedule and Modernized Compliance Process and Technology

Individuals With Unreported Income

The STTG plan describes reforms for individuals with income that is not currently reported by third parties. The reforms include increased reporting by banks of deposits and disbursements in the bank accounts used by taxpayers for their business activities, a schedule attached to the taxpayer's return to reconcile the bank reporting with the tax return and a modernized technology-supported compliance program to make use of all available data.

See Exhibit 3 for details of calculations used for the STTG plan.

We based our estimates of the revenue gains under this plan on the most recent IRS Research, Applied Analytics, and Statistics study titled *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013.*

Taking into account the amounts that IRS existing enforcement activities already collect, and eliminating any gain from income taxpayers below the top quartile of the income distribution, the net gain from these proposed STTG reforms in the 2011 through 2013 period of the IRS study would have been $57.3 billion if the plan were fully effective in that year.

This is equivalent to $78.7 billion for fiscal year 2019.

The IRS study showed $109 billion of tax lost from individual returns with underreported income of the type that has "little or no information reporting." An additional $15 billion is lost from related self-employment income, for a total of $124 billion. (The IRS study identified a total of $45 billion of tax loss from self-employment income, but we only included a proportion that we could relate directly to the underreported business income.) For this category of income, 55 percent of the income that should have been reported was not reported.

The same IRS study showed that the categories of income that had "some information reporting" had only 17 percent underreporting.

We estimate that the STTG plan will move the $124 billion category of underreported income to the "some information reporting" category. With additional reporting and IRS follow up, this move to the "some information reporting" category would reduce the underreporting percentage from 55 percent to 17 percent.

In addition, using a similar approach, $36 billion of underreported income identified in the IRS study would be moved from the "some information reporting" category to the "substantial reporting" category, thereby reducing the underreporting percentage from 17 percent to 5 percent.

As shown in Exhibit 3, these numbers from the IRS study were adjusted downward to account for the STTG plan is to provide the new information reporting only for the top quartile of individual taxpayers.

A modernization of the IRS compliance program, making use of modern advanced analytical models to use additional data recommended by the STTG plan, would be an essential aspect of realizing the potential revenue that could be generated. This is explained in more detail in the section of the STTG main plan titled "How the

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a supplementary reconciliation schedule that taxpayers can use to explain differences between the information report and their return without the need for IRS follow-up.

modernized compliance and assistance program would work in our *Tax Notes* article published on September 11, 2020."

In extrapolating from a 1-year gain to an actual gain over 10 years, we have assumed a conservative curve that converges over 10 years. We assume we do not reach the target level until the final year. This estimate is discussed below in the section on projections.

Mid-sized Pass-throughs: S Corporations and Partnerships

We did not include any estimate of revenue gains from pass-throughs with over $25 million receipts because we assume large pass-throughs are mostly technically compliant We believe all IRS compliance tools would be used to find non-compliance in these large pass-throughs, but we did not have a basis for estimating revenue from this source. We view this as a very conservative assumption in our estimates. A recent study by National Bureau of Economic Research, released after our calculations were completed, estimates that tax evasion in the top one percent of the income distribution was much greater than previously estimated, much of it through use of partnerships.[15]

STTG proposes reforms for the compliance program for mid-sized pass-through businesses that are similar to that for individuals with business income.

This includes increased reporting by banks of deposits and expenditures in the bank accounts used by taxpayers for their business activities, a schedule provided to the IRS to reconcile the bank reporting with the tax return and a modernized compliance program supported by advanced technology together with some focused field audits. Only pass-throughs with ownership interest by top quartile taxpayers would receive the 1099New, but we estimate that as much as 97 percent of all pass-through income is received by the top quartile taxpayers.

See Exhibit 4 for details of the calculations for this calculation.

We estimated the revenue gain from this plan based on the only available IRS compliance study of S corporations and the most recent IRS Research, Applied Analytics, and Statistics tax gap study, titled *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013.*

The IRS tax gap study provided data on the amount of underreported tax (NMA) and the percentage of underreported tax (NMP) by visibility category. Business income of sole proprietors fell into the lowest visibility category with an NMP of 55 percent.

The IRS study of S corporations found that those with under $200,000 receipts (2004 dollars) were comparable to small proprietors, while those over that level had an NMP that was half that amount. The conclusions of this study are completely consistent with the factors that generally drive compliance—lack of meaningful third-party reporting and negligible audit activity (on the order of one-tenth of 1 percent for pass-throughs)

Using these statistics, and SOI tax year 2016 data on the income of the mid-sized pass-throughs, we calculated the net gain in tax in the same manner as described above for individuals with underreported income.

We then adjusted the gain for the amount that would be collected through existing enforcement.

For all unreported income, enforced and late payments are 14 percent of the gap. In the case of these entities, there's negligible direct enforcement, but assuming that some unreported income is detected in audits of individuals, we assumed that half of this general ratio is collected.

These calculations result in a net gain in tax year 2016 of $52 billion, if the plan were fully effective in that year. This is equivalent to $64 billion in 2019 dollars. This estimate was not materially affected by the change in our plan to limit the 1099New to the top quartile of taxpayers because such a large fraction of pass-through income in earned by top quartile taxpayers.

We assume that the phase-up curve of compliance would be the same as discussed above for individuals with business income. This phase-in methodology is discussed further in the section on projections.

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[15] National Bureau of Economic Research: Guyton, Langetieg, Reck, Reish, and Zucman (March 2021). "Tax Evasion at the Top of the Income Distribution: Theory and Evidence." Working Paper 28542. Cambridge, MA.

Projection Methodology

As discussed above, the revenue gain from proposed reforms under STTG was estimated for a baseline year using IRS compliance studies. We applied the same methodology for the tax gap plan for individuals and medium-sized pass-throughs. This baseline year analysis shows what the revenue gain would have been for that year if the plan had been fully effective. These baseline calculations are detailed in Exhibits 3 and 4.

We first projected forward the estimated annual tax gain from the base years using CBO's projection of total Federal tax receipts. We used this index because the tax gap itself is a calculation of the shortfall in receipts from taxes that are due but not paid. The tax gap ratio to total receipts has been reasonably steady over the last several compliance studies. This estimate was projected forward for each year in the 10-year period 2020 through 2029, since we were using a convention that the reforms were passed into law in 2019 and made effective as of January 1, 2020. These projections are shown in Exhibit 1, including the backup indices used to make the projections. This calculation shows what the revenue gain would be for each year in the period if it were fully effective in that year.

Since we assumed the proposed plan would not be fully effective until the 10th year (2029), we then backed down the revenue estimates each year to allow for the phase in the plan and the likely taxpayer response during the period.

At the end of the 10-year period, nearly the full projected tax gain is achieved.

This assumption does NOT imply 100-percent compliance in reported income. It only implies that misreporting will be reduced to the misreporting percentage associated with the next higher level of visibility of income. For example, misreporting by individuals with income in the lowest visibility category, which is 55 percent, would drop to 17 percent misreporting associated with the next visibility category. In other words, in this example, even after 10 years of increased reporting and enhanced 100-percent technology processing of returns, it assumes that the tax on 17 percent of the business income still would not be reported. This level of underreporting is more than three times the level of misreporting for income such as dividends and interest that receive 1099 reports (which is 5 percent).[16]

In addition, the IRS data that shows reporting compliance at each visibility level is voluntary compliance, before adding whatever IRS gets from enforcement through examination and matching. In other words, for the "some reporting" visibility category, the voluntary compliance is 83 percent (100 minus 17). The additional income that the IRS recovers from enforcement is on the average about 3 percent of the unreported income, thus over 99 percent of the income that is reported in this visibility category is from voluntary compliance as compared with enforcement.[17] In our estimates we counted maximum total compliance in the final year of the plan, including both voluntary and auditing, at the 83 percent level. However, we assumed a much more conservative estimate of what fraction of that revenue would come from voluntary compliance versus enforcement. Our final year estimates are that only 58 percent of the revenue would come from voluntary compliance and the rest from some form of enforcement. Much of this enforcement we propose would be much more data driven, more focused and more efficient than traditional audits, but we considered any follow-up with taxpayers to fall under the heading of "enforce-

[16] Internal Revenue Service (IRS) Research, Applied Analytics and Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013,* Publication 1415 (Rev. 9–2019), Washington, DC. "These most recent estimates continue to confirm the relationship between reporting compliance and third-party information reporting that was demonstrated by prior tax gap estimates. For the individual income tax, reporting compliance is far higher when income items are subject to information reporting and even higher when also subject to withholding. As shown in Figure 3 on page 14, from the individual income tax underreporting tax gap estimates, the net misreporting percentage (NMP) for income amounts subject to substantial information reporting and withholding is 1 percent; for income amounts subject to substantial information reporting but not withholding, the NMP is 5 percent; and for income amounts subject to little or no information reporting, such as nonfarm proprietor income, the NMP is 55 percent. The grouping of items into categories is the same as for the TY 2008–2010 estimates."

[17] Visibility category 3 with "some information reporting"

Net misreporting percentage	17 percent
Voluntary reporting percentage	83 percent
Average percent of gap recovered by exam and AUR	3 percent
Amount recovered by auditing and AUR	0.5 percent
Total reported after enforcement	83.5 percent
Percent reported by voluntary compliance	99 percent

ment.” Our proposed follow-up enforcement process is discussed in detail in our September 11, 2020 *Tax Notes* article and in Appendix B.

We made this more conservative assumption about the ratio between voluntary compliance and enforcement because the sources of income in the lowest visibility category have been historically much more non-compliant and more difficult to recover. To the extent that voluntary compliance in this category increased to more historical levels, the amount of required enforcement would decrease.

In our enforcement estimates we did not specifically allow for collection enforcement on underreported taxes assessed but not paid. Since 100 percent of our estimated revenue is from upper income taxpayers the amount of collection enforcement should be small relative to the underreporting component. Some additional collection resources would likely be required but we believe our estimate of enforcement is sufficiently large to provide for them.

Our final calculation was to estimate the time phasing of the increase in estimated revenue over the 10-year time period. This phase-up is also shown in Exhibit 1, broken down between voluntary compliance and enforcement by year. This estimate is judgmental but is based on both the factors affecting taxpayer behavior and the specific milestones in the STTG plan.

Factors Affecting Taxpayer Behavior

Initiation of third-party reporting for business income and the requirement for preparing a reconciliation schedule would produce an initial voluntary increase in compliance. This would occur for three reasons:

- Taxpayers would have a new document which would provide specific information on what to report and would serve as a reminder to do so,
- Tax preparers would be on notice that the IRS has verifiable information, and
- The risk of non-compliance would obviously increase, especially if this risk is effectively communicated by the IRS.

In addition, it would be important for the IRS to increase some field auditing based on this new information, even while upgraded technology was being implemented. This auditing would produce immediate revenue, show taxpayers that the additional reporting was being used and, very importantly, produce valuable data to inform the machine learning models.

These considerations would lead to a partial but immediate increase in compliance in the first years after the increased reporting occurred.

On the other hand, some taxpayers would ignore the requirement but would eventually comply once the IRS notified them of deficiencies in their returns and followed up appropriately. This increase in compliance would build up gradually over time, driven in part by the build-up in the IRS of enhanced compliance programs, which we refer to as enhanced matching, E-exams and field exams. As described in more detail in our September 11th *Tax Notes* article and in Appendix B on our recommended technology program, each of these compliance programs would be data driven using machine learning technology to initiate the process.

Some taxpayers would actively resist compliance and require aggressive enforcement to produce eventual compliance, including in a few cases potential criminal prosecution where outright fraudulent behavior has occurred.

Assuming the IRS over a 10-year period implements the improved technology and enhanced compliance programs recommended by the STTG plan, compliance would converge to a level close to that which already exists in the categories of income where substantial third-party reporting exists, which is what our estimate assumes. This conclusion is clear from the long-term data on the level of compliance where third-party reporting has been in effect for a long time.

STTG Plan Milestones

The timeline for the start-up of the plan is based on the following key milestones (discussed more fully in our Plan Update 1 and Appendix B):

- *Authorizing legislation passed,* allowing plan to begin after startup and planning period.
- *First full year of STTG.* IRS issues guidance and education materials to taxpayers and preparers, describing the plans for the 1099New information report and reconciliation schedule. IRS provides restricted access to financial institutions to determine which taxpayers will receive the 1099New.

- *Second full year of STTG.* Taxpayers receive first 1099New. IRS provides additional detail and educational materials to taxpayers and preparers concerning the 1099New and the optional reconciliation schedule. Taxpayers file returns using 1099New with optional reconciliation schedule. IRS initiates traditional examinations of returns using 1099New and other existing data, and begins to build models.
- *Third full year of STTG.* Taxpayers receive 2nd year of 1099New, and those over $400,000 income and pass-through entities are required to file reconciliation schedule. IRS expands traditional examinations and expands models.

Beginning in the 2nd year, a modest amount of enforced compliance will occur, and then will increase as the IRS builds its enhanced technology-enabled compliance program. Compliance gains will then level off and only increase gradually as more enforcement cases will occur.

As shown in Exhibit 1, we estimated a voluntary compliance ratio and enforced compliance ratio for each year. The voluntary compliance ratio is the fraction of the full gain that would be achieved in that year from voluntary compliance and the enforced compliance ratio is the fraction of the full gain that would be achieved through all forms of enforcement activity.

Our assumption is that the voluntary compliance ratio will start at 20 percent, which means that 20 percent of the difference between the lower visibility category and the next lowest would be reported.

History shows that when additional specific supporting documentation is required from taxpayers, compliance increases. See Exhibit 5 for the immediate effect of additional reporting in the Tax Reform Act of 1986.

Some revenue will be received in the first full year of the plan because taxpayers with business income must file quarterly estimates and are subject to penalties for underpayment.

Overall, during the 10-year period the STTG plan would steadily shrink the tax gap as compared to its current unmitigated trajectory. By 2029, it would reduce the gap by approximately $242 billion, a 26 percent reduction. Over the 10-year period, it would reduce the tax by a cumulative 19 percent.

While we have not estimated what would happen after the first 10-year period, we believe the gradual progress in shrinking the gap would continue. Even after the projected gains in the first 10-year period, 74 percent of the tax gap would remain to be addressed. Some staff resources could be reassigned from cases with business returns to non-business returns and non-filing cases. The nature of the process proposed by STTG is one of continuous improvement, using data gathered to improve the models and the process. This would enable increasingly precise assessments of noncompliance in specific returns and increasing efficient communications with taxpayers.

Adjusting to Different Start Years

Using these conventions, the estimates in this report could readily be revised for an assumption about any later start year.

Any multi-year projection is subject to error because of variations in the forecast of underlying macroeconomic variables, such as GDP and total tax receipts. We used the latest Congressional Budget Office (CBO) projections for these variables and therefore our projections contain the same level of likely variations as the CBO projections, which are also used to project tax revenue in the existing tax system. On a relative basis, we do not know of any reason that the revenue results under our plan would vary more or less than those the CBO makes for the current tax system.

Exhibit 1: Projection of Gains from STTG (formerly referred to as TCAM)

Estimated Revenue Gain from STTG over Ten Years including comparative statistics

Exhibit 1 **8-Apr-21**

This sheet estimates the revenue gain from the STTG proposals over a ten year period
The etimate assumes that the proposals were passed in calendar 2019 and became effective
for tax years beginning January 1, 2C The phase in methodology is explained in Appendix A
see data sources tab for data sources
is revision adjusts the phase-in of the revenue gain to correspond with the timeline in Appendix
and update 1 limiting information reporiing to top quartile individualsand related passthrough businesses
dollars in billions

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	Cumulative 20-29	
Tax Gap Proposals																			
Individuals with AGI in top quartile and low visibility income																			
One Year full Gain net of existing enforcement Exhibit 3	57.3																		
Index: CBO total receipts base =2011-2013 average	1	1.203905	1.294766	1.30234	1.32147	1.32625	1.3752872	1.4425724	1.5112671	1.5824131	1.6589956	1.7500844	1.8270283	1.95274376	2.07452032	2.1477868	2.2393928		
Future Year full Gain before Adjustments	57.3	69.0	74.2	74.6	75.7	76.0	78.8	82.7	86.6	90.7	95.1	100.3	104.7	111.9	118.9	123.1	128.3	1,042.10	
Voluntary response ratio (see appendix)								20%	35%	43%	48%	50%	51%	52%	54%	56%	58%		
Enforced response ratio (see appendix)								0%	5%	10%	15%	20%	25%	30%	35%	38%	41%		
Phase in shortfall ratio (1- total response)								80%	60%	47%	37%	30%	24%	18%	11%	6%	1%		
Shortfall amount due to phase in	57.3	69.0	74.2	74.6	75.7	76.0	78.8	66.1	52.0	42.6	35.2	30.1	25.1	20.1	13.1	7.4	1.3	292.97	
Net Gain after phase in	0.0	0.0	0.0	0.0	0.0	0.0	0.0	16.5	34.6	48.1	59.9	70.2	79.6	91.8	105.8	115.7	127.0	749.14	
Medium -sized passthroughs, under $25 million receipts with ownership by top quartile individuals																			
One Year full Gain net of existing enforcement Exhibit 4	52.2																		
Index: CBO total receipts base =2011-2013 average	1	1.203905	1.294766	1.30234	1.32147	1.32625	1.3752872	1.4425724	1.5112671	1.5824131	1.6589956	1.7500844	1.8270283	1.95274376	2.07452032	2.1477868	2.2393928		
Future Year full Gain before Adjustments	52.2	62.8	67.6	68.0	69.0	69.2	71.8	75.3	78.9	82.6	86.6	91.3	95.3	101.9	108.2	112.1	116.8		
Voluntary response ratio (see appendix)								20%	35%	43%	48%	50%	51%	52%	54%	56%	58%		
Enforced response ratio (see appendix)								0%	3%	7%	11%	17%	22%	26%	32%	36%	41%		
Phase in shortfall ratio (1- total response)								80%	62%	50%	41%	33%	27%	22%	14%	8%	1%		
Shortfall amount due to phase in								60.2	48.9	41.3	35.5	30.1	25.7	22.4	15.2	9.0	1.2	289.46	
Net Gain after phase in								15.1	30.0	41.3	51.1	61.2	69.6	79.5	93.1	103.1	115.7	659.50	
Total STTG Tax Gap Gain								31.6	64.6	89.3	111.0	131.4	149.2	171.2	198.9	218.8	242.7	1,408.64	105%
Tax Gap if ratios unchanged (Unmitigated tax ga See Exhibit 2 for calcuation of tax gap in 2019							574.2	602.3	631.0	660.7	692.7	730.7	762.8	815.3	866.1	896.7	935.0	7,593.22	
Gain as % of tax gap								**5%**	**10%**	**14%**	**16%**	**18%**	**20%**	**21%**	**23%**	**24%**	**26%**	**19%**	
Total STTG Tax Gap Gain								31.59	64.60	89.34	110.96	131.38	149.16	171.23	198.89	218.79	242.71	1,408.64	
IRS Budget Increment								0.71	1.71	2.66	3.91	5.26	6.79	8.70	9.94	11.36	11.54	**62.60**	
Grand Total Gain Net of IRS Budget Increment								**30.9**	**62.9**	**86.7**	**107.0**	**126.1**	**142.4**	**162.5**	**188.9**	**207.4**	**231.2**	1,346.03	
CBO Estimate of Receipts								3620	3792	3971	4163	4392	4585	4900	5206	5390	5619	45,636.76	
% increase in Receipts								0.9%	1.7%	2.2%	2.6%	2.9%	3.1%	3.3%	3.6%	3.8%	4.1%	2.9%	
CBO Estimate of GDP								22231	23083	23946	24836	25769	26765	27775	28860	29981	31141	#########	
Receipts as % of GDP								16.3%	16.4%	16.6%	16.8%	17.0%	17.1%	17.6%	18.0%	18.0%	18.0%	17.3%	
Receipts Increment as % of GDP								0.1%	0.3%	0.4%	0.4%	0.5%	0.5%	0.6%	0.7%	0.7%	0.7%	0.5%	
CBO Receipts plus STTG increment as % of GDP								16.4%	16.7%	17.0%	17.2%	17.6%	17.7%	18.3%	18.7%	18.7%	18.8%	17.8%	
ratio of revenue gain to IRS increment								45	38	34	28	25	22	20	20	19	21	23	
Individual Income tax paid by bottom 90%; see indices tab								550	578	605	634	663	694	764	834	866	904	7,091.33	
Ratio of Revenue Gain to Tax paid by bottom 90%								6%	11%	15%	18%	20%	22%	22%	24%	25%	27%		

Exhibit 3 -1 Tax Gap Calculation of gain from underreported income of individuals in top quartile of AGI

Calculation of tax gain related to proposal for additional third party reporting of individual income with reconciliation schedule and advanced technology

This sheet estimates the tax gain that could be obtained by improved external reporting of income reported by individuals. It is based on the IRS compliance study of returns in tax years 2011-2013 which includes data showing how misreporting varies depending on the degree of external reporting
Specifically , this sheet calculates the gain if the tax lost on income that is now subject to" little or no reporting" were reduced to the level of income that is now subject to "some reporting"
It also applies this reduction to self-employement tax that is related to the misreported income Finally a reduction a reduction in the next lower tier of amount with" some reporting "is reduced to the level with "substantial reporting"
Finally, the amounts are extrapolated to future years based on CBO estimatess of total revenue
The gain is adjusted to account for tax that would be collected by existing enforcement and for the exemption from reporting of taxpayers with agi of at least 84,000 in ty 2018 top 25% of taxayers

		2011-2013 study
IRS summary tax gap data from 2011-2013 study		
tax paid voluntarily and timely		2242
tax eventually paid		2302
gross tax gap		441
enforced and late payments		60
net tax gap		381
enforced and late as percent of underreporting gross gap		14%
Underreporting gap		352
self employment gap		45
gap by visibilty tier		
	NMP	NMA
individual income tax gap with little or no reporting	0.55	109
self employement tax gap related to above(see calculation belo		25.0
Fraction of income over 84923(top 25%)	49.4%	53.9
self employement tax related to above		12.3
gap with some reporting	0.17	36
NMP with substantial reporting	0.05	

calculation of additional tax by visibility categroy if NMP is improved to next tier
See lines below for derivaion of formula

	2011-2013 study	
	no=.55	some=.17
	nma	tax gained
low visibility business income	53.9	**37.23204**
related SE tax	12.3	**8.524284**
	66.2	45.75632
next visibility tier income	0.17	0.05
	36	**25.41176**
Total tax gain		71.16809
enforced and late payments under existing method (applied to nma) 14%		13.90833
Net gain after tax that would be collected under existing methods		57.25975
net gain after exemption		**57.25975**
brought forward to 2019 1.375287194		**78.74861**
factor based on receipts		

derivation of formula for tax gain from increased reporting

		alternative calculation if NMP is half (.275)
	2011-2013 study	2011-13 study
Net Misreported Amount	109	54.5
Net Misreported %	0.55	0.275
Amount that should have been reported	198.1818	198.1818
nma/nmp		
Amount reported	89.18182	143.6818
NMP with higher visibility	0.17	0.17
NMA with higher visibility	33.69091	33.69091
gain	75.30909	20.80909
% of NMA gained	69%	38%
equivalent to (NMPH-NMPL)/NMRPH	69%	38%
gain as percent of actual reported	84%	
% of NMA reported for some reporting categry		
move from 17% NMP to 5% NMP	71%	

Income distribution of sole proprietors by repoted net income used to calculate SE tax and exemption amount

SOI Data for tax year 2016 distribution of net income of sole proprietorships

				number of returns		
total	328.2	total positive	350.1	25.5		
<2500	-20.5	cumulative positive		6.2	24.3%	
2500-5000	-1.4			2.7	34.9%	Calculatiions of SE limits
5000-1000	7.1		2.0%	3.5	48.6%	
1000-25000	41.2		13.8%	5.4	69.8%	% over se limit
25000-50000	43.2		26.1%	3.1	82.0%	assuming midpoint
50000-100000	59.1		43.0%	2.2	90.6%	of bracket
100000-200000	57.4		59.4%	1.3	95.7%	51%
200000-500000	67.6		78.7%	0.8	98.8%	% under se limit and
500000-1000000	34.2		88.5%	0.3	100.0%	ove exemption
1000000-2500000	23.5		95.2%	0.1	100.4%	25%
2500000-500000	8.2		97.5%	0.025	100.5%	
>5000000	8.8		100.1%	0.011	100.5%	Weighting of % under se limit
						33%

Calculation of self employment tax retated to unreported business income

Effective SE rate on income under 132900		asssumes top tax bracket of 37%		
	11.5%			this adjusts for part of se tax that is deductible
Effective SE reate on income above 132900		2.9%		this is the part of the tax that is uncapped
weigthed average	5.7%			this weights the rates for the fraction that is over the cap
Convert to percent of NMA				
Asssume 25% average tax bracket for NMA		0.25		
SE tax as % of NMA			22.9%	this converts the se tax to a percentage of the nma
				this fraction is carried to H29

Note this calculation of related self employment tax is slighty understated because the Update 1 to the information reporting proposal did not include an exemption but did limit the reporting to the top quartile of taxpayers
We have not adjusted for that difference in estimated self employement tax as that calculation is complex. Instead we have adjusted the overall misreported tax by the overall top 25 rate(g30)_ without eliminating the lower income exemption. This understates the gain related to self-employement tax

The source of the data in this spreadsheet is the following:
Internal Revenue Service Research, Applied Analytics & Statistics
Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013 Publication 1415 (Rev. 9-2019)
Washington, DC Sep-19

Exhibit 4 -1 Tax Gap Gain pasthroughs Update 1 **Includes all passthroughs** **allows for ownership exclusion**

Calculation of tax gain related to proposal for additional third party reporting of business income of S corportions and Partnerships

under $25 million receipts with reconciliation schedule and advanced technology

This sheet calculates the tax gain from the reform proposal as applied to S corporations and partnerships

In this update, passthroughs required to have third party reporting would be those with an ownership interest by individual taxpayers who meet the AGI criteria, either 400,000, or to 25% ($85,000) AGI

It differs from the calculation as a basis for the tax notes article published in September 2020, as follows

it it does not exclude passthroughts over $25 million from the calculation

It does not exclude passthroughts with under $25,000 gross receipts

It makes an estmate of the maximum revenue lost from passthroughts that do not meet the ownership criteria

It first divides passthroughts below the $25 million threshold for large passthroughs. It further divides the passthroughs to those with receipts under and over $500,000.

The IRS compliance study of S corporations found different levels of misreporting for two similar size categories., using a threshold of $200,000 in 2004 dollars

We used a threshold of $500,000 as the most similar size category availabe in 2013 data. For those under the lower threshold, the misreporting percentage is comparable to sole proprietorship while for those over the threshold the misreportiing perentage is half that of sole proprietorships

This sheet calculates the tax gain based on the ratio of income for each size category of passthrough to that of individual business income, most of which is sole proprietor income and then applies the appropriate misreporting percentage. Finally it applies the tax gain percentage as derived in the analysis of individual business income underreporting. It adjusts for the fraction from existing enforcement and for the exemption of passthroughs under $25,000 receipts. Partnership income is adjusted for income received from other partnerships.

An estimate of the gain from large passthroughs is estimated by extrapolation from the medium sized passthroughs

dollars in thousands

	All		Under 500,000 receipts		500,000 to 25 million receipts	total mid-sized passthroughs	Over 25 million		
Number of returns									
Sole proprietors	24,074,684				NA				
S-corporations	4,257,909		3,041,574		1,191,218	4,232,792	25,118		
Partnerships	3,460,699		2,486,791		902,585	3,389,376	71,323		
total S-corporation	7,718,608		5,528,365	-	2,093,802	7,622,168			
Total Receipts									
S-Corporations	$ 6,745,095,028		381,378,110		3,117,878,491	3,499,256,601	############		
Partnerships	$ 5,068,975,400		547,224,287		1,847,789,041	2,395,013,328	############		
total s corp and partı	11,814,070,428		928,602,397	-	4,965,667,532	5,894,269,929	5,919,800,499		
Positive business income, all sources:									
Sole proprietors	357,417,038								
S-corporations	455,520,185		71,754,889		206,506,467	278,261,356	177,258,829		
Partnerships	647,046,634		88,033,966		265,019,076	353,053,042	293,993,592		
Total Pass	1,102,566,819		159,788,855		471,525,543	631,314,398	471,252,421		
estimated income below $25000 receipts			23,000,000						
Ratio of total Passthrough Income to sole propri			44.7%		131.9%		131.8%		
dollars below in billions									
Calculation of Gain									
ratio of TPT income to sole proprietor income			44.7%	131.9%			131.8%		
ind bus income NMA	109								
calcualted NMA for TPT									
based on ratio of TPT income to ind bus income			48.73	143.8			143.7		
ratio of TPT NMP to ind bus income NMP			1	0.5			0.33		
nma for pws			48.73	71.90		120.63	47.43		
fraction gained (see tax gap tab)			0.69	0.38	total gain		0.06		
gain from passthroughs			33.62	27.32	60.95	63.79	2.85	Note this gain of 2.85 billion is on income of 471 billion	
adjustment for exemption under 25000 receipts			-		-			A net gain of only	0.6%
gain after exemption					60.95	63.79			
adjustment for enforced and late payements through existing enforcement					4.27	4.47			
see appendix for discussior		0.07							
net gain after existing enforcement					**56.68**	**59.33**			
Fraction of passthrough income excluded due to ownership exclucsion									
breakeven fraction	10%	top 25% taxpayers actually have 97% of category 3 income				**5.93**			
Net Gain						**53.39**		**Note this compares to a gain of**	
								52.18 in september 2020 estimate	
net gain rolled forw	1.243623063				70.49			**Essentially the same gain**	
total receipts rolled forward to 2019					7,330,250,023				
net gain as % of receipts					1.0%				
Business Income rolled forward to 2019					785,117,145				

The IRS 2011-2013 compliance study identified 109 billion of tax gap due to underreported business income

About 64% of this was from sole priopprietor income.

we use sole proprietor income as the best estimate for comparisons

to mid sized passthroughs

Sources:

TY 2013 forms 1040, 4797, 1065, and 1120S, dollar amounts in $ 000

DEG Analysis by receipts size

Internal Revenue Service

Research, Applied Analytics & Statistics

Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013 Publication 1415 (Rev. 9-2019)

Washingtı Sep-19

SHRINK THE TAX GAP, INC. HISTORY AND BIOGRAPHIES

Our History and Objectives

Shrink the Tax Gap is a non-profit entity organized under section 501(c)4 of the Internal Revenue Code.

Purpose—Our purpose is to make the Federal tax system fair for everyone who pays their taxes by proposing plans to increase overall compliance, raising more revenue from taxes already in the tax code, and making it faster and easier to interact with the IRS.

Sponsorship—Our organization has two directors: Charles O. Rossotti and Fred L. Forman, both private citizens. We have no affiliation with or sponsorship from any other individuals or entities.

Relationship to the IRS—Our work has been done entirely with public data and without any consultation with or support from the IRS or any current IRS employees. One retired IRS employee was paid to provide part-time administration support such as document preparation and scheduling. Other former IRS employees have voluntarily and without compensation chosen to comment on our articles and some have posted comments on our website.

Employees and Vendors—We have no employees. As noted above, we pay one part-time person to provide administrative support. We pay other vendors and service providers on a commercial basis.

Funding—To date all funding has been provided personally by Charles O. Rossotti. We do not plan to solicit any funds from other parties. In the future, if we accept funding from any third parties, we will disclose those donors on our website.

Background Statements for Charles Rossotti and Fred Forman

Charles Rossotti served as IRS Commissioner from 1997 to 2002 and on President Bush's panel on tax reform in 2005. Since then, I have not been involved in any tax professional activities, and I am not a tax advisor to anyone. I have been and continue to be engaged in business and non-profit activities, including serving as a part-time advisor to The Carlyle Group. My principal business activity is investing and serving on the boards of companies. My work on the Shrink the Tax Gap program is not connected in any way with The Carlyle Group or any business entity.

In 2019 as the presidential campaigns got underway, it became apparent to me that the Federal Government would face a very difficult financial challenge over the next decade as demands for spending and tax relief would be high while the budget deficit was already high and growing. I believed that whatever else was done to resolve this dilemma part of the solution should be a more sound and fair tax administration system that collected more of the taxes already in the tax code. I drafted a proposal for this purpose, based on ideas I had been thinking about since my years as IRS Commissioner and on President Bush's tax panel. This culminated in an article I published in the journal *Tax Notes* in March 2020. At that time, I did not plan to do anything more on the subject.

After the first *Tax Notes* article was published, I received a number of generally positive inquiries and indications of interest in my proposal. Many of the inquiries were about how the proposal could be implemented. Based on this response. I decided to develop the proposal in more detail. At this time, Fred Forman joined me in the work.

Fred Forman was our senior technology executive at American Management Systems, where I was CEO. From 2000 until 2004 he joined the IRS as Associate Commissioner for Business Systems Modernization. Since then, he has done occasional consulting for businesses and is engaged in various non-profit activities. He is not involved in tax advisory or other tax-related activities.

In September we co-authored a second article in *Tax Notes* providing more details on how our proposal could be implemented. We also updated our website *www.shrinkthetaxgap.com* to provide more information on our Shrink the Tax Gap plan and to post comments.

Based on comments received on our articles we continue to update the plan. All updates are posted on the website.

In September we started to discuss our plan with interested parties and to obtain feedback and support. We continued to post news coverage and comments on the website. Some individuals who posted comments are also reaching out to discuss the proposal with their personal networks. In addition, we set up Shrink the Tax Gap pages on various social media networks.

In November 2020 Fred Goldberg joined our team.

On January 14, we incorporated Shrink the Tax Gap, Inc. as a 501(c)4 organization to manage our activities more formally. Before this incorporation, we managed our activities as individuals.

In April 2021 David Borden, a lawyer and economist, joined our team.

We will continue to update our plan as we receive comments and suggestions. We will reach out to and work with all those interested in our ideas on how to improve the fairness and effectiveness of the tax system. All of us working on the program view this as a public service activity that we can now do as private citizens, much as we did public service as government officials earlier in our careers. It is a way we believe we can make constructive use of our years of experience in business, government, and technology.

QUESTIONS SUBMITTED FOR THE RECORD TO HON. CHARLES O. ROSSOTTI

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. Under your proposal, what information will be required to be provided on the proposed Form 1099New?

Answer. Only two items for each account, once a year: total deposits, total withdrawals.

Question. Will taxpayers' information be limited only to deposits and withdrawals from "depository" accounts, or will it require information with respect to other accounts?

Answer. We recommend that the Treasury be given authority to specify what types of accounts would be covered, as the world of financial accounts changes regularly. The intent would be to include all accounts able to be used to accept receipts in payment for goods or services.

Question. Does the IRS already have access in some other manner to the information that would be contained your proposed Form 1099New?

Answer. The IRS has access to other information reports that cover parts of business receipts, including the recently expanded 1099K, but none that cover substantially all. The IRS could determine that information in the course of an audit, but otherwise does not have full access to that information for use in determining likely underreporting of income.

Question. Could the IRS better use the partnership income reports it has collected for years? If so, how?

Answer. The IRS receives K–1s prepared by partnerships that show the income allocated from the partnership to its partners. With increased investment in technology, the IRS could make better use of this information. The IRS receives only very limited information on the receipts or the income received by the partnership itself.

PREPARED STATEMENT OF HON. JOHN THUNE,
A U.S. SENATOR FROM SOUTH DAKOTA

Thank you, Chairman Whitehouse. Let me begin by saying I'm looking forward to working on this subcommittee with you.

The Subcommittee on Taxation and IRS Oversight covers a number of important issues, perhaps none more so than the responsible stewardship of taxpayer dollars. And I am optimistic we will work to find common ground and common solutions.

Today, we are here to discuss the tax gap—what it is, what its components are, and how to reduce it. The chairman also has a particular interest in the role of offshore tax evasion, an important issue as well.

The tax gap is real. Republicans on this committee support closing it.

The tax gap—the difference between taxes owed and paid—has been a stubborn problem for decades. The IRS periodically estimates the tax gap using audits and other data it collects. As of September 2019, the IRS estimates the average gross tax gap at $441 billion per year for 2011–2013. After late payments and enforcement, the net tax gap is $381 billion.

While those numbers are improvements from preceding years, the tax gap remains a problem. The IRS Commissioner even speculated that the tax gap could be as much as $1 trillion per year—a number that far exceeds the official IRS estimate.

While that guestimate may conflate the tax gap with tax evasion, one thing is certain: no one at any income level should believe they are safe in cheating on their taxes. And we should pursue bipartisan measures to reduce the tax gap and better enforce our tax laws.

But any such effort must strike the appropriate balance between taxpayer responsibilities and taxpayer rights. To address the tax gap, some believe that increased IRS resources, tax audits, and intrusion of taxpayers' personal information will automatically yield a golden goose of revenue.

For example, President Biden recently proposed increasing IRS funding by $80 billion over the next 10 years, projecting those funds would net $700 billion over the decade. Former IRS Commissioner John Koskinen, who served as Commissioner under Presidents Obama and Trump, said he thought that $80 billion was too much. I agree.

Based on official estimates about the tax gap, and what can reasonably be collected, a return of $700 billion is a tall order as well. An analysis from the Wharton Business School projected a lower payoff by $220 billion.

CBO estimated that increasing IRS funds for examinations by $40 billion over 10 years would increase revenues by $103 billion, resulting in a net $63 billion decrease in the deficit. It is not to say that better utilized or enhanced resources couldn't help find real money, but let's be straight about the return on investment—particularly when those figures are portrayed as offsets for new spending proposals.

Republicans are open to discussions about IRS resources, but those discussions should include measures to improve customer service, ensure existing resources are allocated optimally, and promote smarter and more effective audits. Just as with President Trump's budgets, which also included additional IRS funding and enforcement resources, any increase to the agency should come with commensurate accountability and transparency.

Memories remain fresh of past IRS use of taxpayer resources to disproportionately single out conservative organizations for extra scrutiny. Some on the other side of the aisle will say that Republicans hollowed out the agency's coffers, but IRS budgets have been generally stable for the past 15 years. Any budget reductions are compared to the agency's all-time high budget of 2010, which spiked under all-Democratic rule.

In addition to boosting enforcement, the Biden administration has proposed tackling the tax gap by requiring banks to give the IRS new documentation on income from businesses such as partnership and sole proprietorships, as well as individuals with business income. Under the proposal, the IRS would soon be receiving troves of new data on taxpayers' bank accounts. As you might imagine, many Americans are understandably concerned with the risk of government overreach. More specifically, they're concerned their local banks could turn into extensions of tax enforcement on behalf of the IRS.

While we should look at ways to improve reporting, the IRS should better use the information it already receives, like partnership income reports it has collected for years. Just for everyone to understand, enforcement is only one method to reduce the tax gap. And it is actually two degrees of separation between the tax gap estimate and revenue that can be scored from enforcement proposals.

CBO budget rules prohibit scoring hoped-for but entirely uncertain revenue from enforcement. Policy-makers need to be reasonable about what is doable on the persistent problem of the tax gap and the limits of score-keeping rules, particularly for near-term spending proposals.

Finally, while we should find bipartisan ways to reduce the tax gap, it's worth noting that our Nation has a relatively high and stable voluntary tax compliance rate. According to the most recent IRS data, about 84 percent of taxes were paid voluntarily and on time. After enforcement efforts and late payments were taken into account, about 86 percent of taxes were paid.

Tax compliance levels remain substantially unchanged since at least the 1980s. There is not one solution to solving the tax gap or one type of taxpayer responsible for it. Reducing the tax gap requires a comprehensive strategy and effective execution from the IRS—and appropriate safeguards and accountability to taxpayers.

We have an excellent panel before us today. Thank you all for being here, and I look forward to hearing your testimony.

PREPARED STATEMENT OF HON. SHELDON WHITEHOUSE,
A U.S. SENATOR FROM RHODE ISLAND

I'm pleased to convene this hearing on the tax gap and the related role of offshore tax evasion. My Republican colleagues and I may disagree on what makes a fair tax code, but we very much agree that everyone should pay what they owe. That principle is what today's hearing is about.

The IRS conservatively estimates the tax gap—the difference between taxes owed and taxes collected—to be $441 billion per year. Commissioner Rettig recently testified that the tax gap may have grown as high as $1 trillion in recent years (trillion with a "t").

One reason for the gulf between the official estimate and Commissioner Rettig's is the bad job the official estimate does incorporating the so-called international tax gap—what is hidden by wealthy individuals and large corporations overseas. Tracking this offshored money is difficult, but we know there's lots of it. Research suggests the Treasury may lose anywhere from $40 billion to $123 billion annually from offshore tax evasion.

Typical American taxpayers don't have the option to hide money abroad, so the wealthy who cheat on their taxes through offshoring also worsen income and wealth inequality. One study estimates the highest-earning 1 percent of taxpayers hide 20 percent of their income, accounting for 36 percent of unpaid taxes. Most Americans pay what they owe, meaning they cover for the tax cheats through higher taxes, fewer public services, or a larger Federal debt.

For large multinational corporations that stretch loopholes beyond recognition to book income to tax havens, the line between legal avoidance and evasion may be paper-thin. It turns on whether an outgunned IRS can beat back the armies of lawyers hell-bent on burying them in litigation.

An outsider looking at these numbers may ask how the most wealthy, powerful country in the world could let this happen. The answer is, we made it happen. Over a decade, Republicans cut the IRS budget by 20 percent, with enforcement hit especially hard. There are 30 percent fewer enforcement staffers than a decade ago, and the number of highly trained revenue agents—who tackle complex audits of the wealthy and large corporations—is down nearly 40 percent. The result: millionaire and billionaire audits dropped over 72 percent, and audits of the largest corporations—those with $20 billion in assets—declined by half. As former Commissioner Koskinen once said, cutting the IRS budget gives a "tax cut to tax cheats." As the IRS budget fell, audit rates for the rich and poor in America converged. A worker receiving the Earned Income Tax Credit is nearly as likely to be audited as a seven-figure earner.

What do we do? We ought to start with the multi-pronged approach put forward by the Biden administration:

- One: Ensure the IRS has the resources it needs to collect what taxpayers owe. It needs a larger staff with the knowledge and experience to untangle the networks of shell companies the ultra-rich and large corporations use to hide their income, often in offshore tax havens. I'd like to explore mandatory funding for the IRS, so the agency has the sustained, predictable support it needs to make long-term investments.
- Two: Require more reporting of the type of income the super-rich tend to hide. Middle-class taxpayers can't hide their wages from the IRS. The super-rich shouldn't be able to either.
- Three: Support a technological reboot at the IRS. The agency still relies on some systems from the 1960s. Modern tools and technology could help root out offshore and other types of tax evasion.

The investment will pay off. Treasury estimates $80 billion to revitalize the IRS will yield $700 billion in revenues—funding we could invest in working families. I'll note that budget scoring rules block Congress from using such high-return investments as pay-fors—that needs to change.

Ramped-up enforcement is essential, but it's no substitute for addressing the injustice in the tax code, particularly tax breaks for the ultra-rich and large corporations. For example, my No Tax Breaks for Outsourcing Act would end the incentive for multinational corporations to shift profits offshore.

I'm pleased to be joined by such a distinguished panel of witnesses to discuss the size and scope of the tax gap, the role of offshore tax evasion, and how to combat it.

COMMUNICATIONS

AMERICAN BANKERS ASSOCIATION ET AL.

May 10, 2021

U.S. Senate
Committee on Finance
Subcommittee on Taxation and IRS Oversight
Dirksen Senate Office Bldg.
Washington, DC 20510–6200

RE: Subcommittee Hearing "Closing the Tax Gap: Lost Revenue From Noncompliance and the Role of Offshore Tax Evasion"

Dear Committee Members:

The undersigned trade associations represent banks, credit unions and related financial institutions of all sizes. We thank you for your interest in better understanding and addressing the causes of the "Tax Gap," and we share your interest in ensuring taxpayers honor their obligations. Our associations agree the government must have adequate funding and resources to promote compliance with our Nation's tax laws, and to that end, our members already provide significant data to the Internal Revenue Service (IRS) and other governmental units. However, recent proposals to create new reporting requirements for financial institutions would impose cost and complexity that are not justified by the potential, and highly uncertain, benefits. Furthermore, we believe additional reporting requirements guided by subjective criteria have privacy and fairness implications and the potential to put financial institutions in an untenable position with their account holders.

President Biden's American Families Plan includes the following:

> The President's proposal would change the game—by making sure the wealthiest Americans play by the same set of rules as all other Americans. It would require financial institutions to report information on account flows so that earnings from investments and business activity are subject to reporting more like wages already are.[1]

At this time, we understand and appreciate there are not detailed official proposals on how the additional reporting requirements and related administration would work. That said, as the Subcommittee begins to consider the feasibility and advisability of this proposal, we encourage you to carefully assess the costs and benefits of imposing a new level of bureaucracy and personal data collection on our already over-complicated tax reporting structure. This proposal will have real costs, not only for government, but also for financial institutions, small businesses, and individual taxpayers. Strengthening IRS funding to facilitate *targeted* auditing of questionable tax returns is a much more efficient and effective approach to closing the tax gap.

Financial Institution Reporting Is Already Robust

Considering all the existing tax and other compliance reporting responsibilities already borne by the financial services industry (Forms 1099, 1098, Suspicious Activity Reports, Currency Transaction Reports, etc.), we have serious reservations regarding the efficacy of yet another reporting requirement. We respectfully suggest that further cost benefit analysis is necessary before moving forward with this proposal. For example, it is not clear that the proposed information reporting require-

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[1] *See* "Fact Sheet: The American Families Plan," The White House Briefing Room, April 28, 2021, *https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/*.

ment would materially improve the IRS's ability to identify non- reporters or generate deterrence for non-reporting over and above the tools already at their disposal. We urge policymakers first to ensure that the existing framework of information collection and oversight is being fully utilized before adopting new requirements. A recent GAO report suggests some existing data is not used due to resource constraints.[2]

In addition, previously enacted policy initiatives aimed at helping to close the tax gap are already at work and likely starting to have an impact. For example, tens of millions of dollars have been expended to comply with the Foreign Account Tax Compliance Act (FATCA), which requires reporting on foreign bank accounts designed to address one of the main sources of unreported and underreported income.

Creating a New Reporting Structure Is Not as Simple as it Sounds

The costs and other burdens imposed to collect and report account flow information would surpass the potential benefits from such a reporting scheme. New reporting would appear to require material development costs and process additions for financial institutions, as well as significant reconciliation and compliance burden on impacted taxpayers. For example, reporting total gross receipts and disbursements would require a new reporting paradigm for depository institutions, which necessitates system changes to collect the information. Those system changes will need to address the myriad challenges that arise when trying to apply a new statutory construct to the complex reality of different account ownership and use structures. A few preliminary hurdles include:

- ◦ Identifying accounts based on taxpayer identification numbers.
- ◦ Defining the entities and account holders within scope of the statute.
- ◦ Navigating privacy concerns related to joint accounts.
- ◦ Specifying definitions for beneficial owners, DBA's (Doing Business As), and "control" of an account.
- ◦ Reconciling business and personal transactions that are commingled in single accounts.

Furthermore, assuming taxpayers have a responsibility to "reconcile" whatever information is provided to them and the IRS by financial institutions, this new reporting structure could create a significant burden on individuals and businesses subject to the requirement—the majority of whom will have nothing inherently suspicious about their returns. The additional compliance responsibilities and complexity of implementation should be carefully considered before these proposals move forward.

Benefits of Enhanced Account Flow Reporting Are Uncertain and Estimates May Be Exaggerated

Given the substantial burden that this proposed reporting requirement would create on businesses, individual taxpayers and financial institutions, it is imperative that the benefits of implementation materially outweigh the costs and risk associated with this large scale collection of sensitive personal financial information. Some of the estimates that have been used to derive the expected benefits from this proposal, however, may be outdated and misleading. For example, one study cites foreign bank accounts as a key source of the underreporting of income, though its underlying data were from a time period that preceded enactment of FATCA requirements to report such accounts.[3] Another study acknowledges the savings it projects are "optimistic" compared to those of the Congressional Budget Office ("CBO") and encourages the CBO and the Joint Committee on Taxation ("JCT") to weigh in on its policy recommendations.[4] We agree that it will be critical, therefore, for the CBO and JCT to independently assess the assumptions and data underlying the forecasted benefits of this proposal.

Providing Enhanced Resources for IRS Audits Is a More Effective, Efficient, and Fair Approach

Assuming there were enhanced resources for audits, we expect it would be standard protocol for IRS auditors to ask taxpayers to do exactly the type of reconciliation under consideration. This analysis would be based on information the taxpayers already have in their possession (*e.g.,* bank statements). Asking financial institutions

[2] GAO Report 21–102; Tax Administration: "Better Coordination Could Improve IRS's Use of Third-Party Information Reporting to Help Reduce the Tax Gap" (December 2020).

[3] *See* Guyton, Langetieg, Reck, Risch, Zucman. "Tax Evasion at the Top of the Income Distribution: Theory and Evidence," *https://www.nber.org/papers/w28542.*

[4] *See* Sarin, Summers. "Shrinking the Tax Gap: Approaches and Revenue Potential," *https://www.nber.org/system/files/working_papers/w26475/w26475.pdf.*

to perform this role, piecing together a picture of individual taxpayers' accounts, is inefficient and indirect, and account holders may rightly question whether this process is being applied fairly.

Additionally, policymakers should consider the issues of protection of account holder data and privacy related concerns. The IRS is already facing challenges and expending resources to handle the problems associated with identity theft and false tax returns filed to claim refunds. The collection of this additional data is only likely to aggravate the problem of identity theft.

As we stated earlier, we support efforts to increase compliance so that all taxpayers meet their responsibilities, but putting financial institutions in the position of reporting more information on their account holders—especially when the benefits are far from certain—is not the answer.

We welcome any opportunity to further discuss our policy concerns on this matter.

Sincerely,

American Bankers Association
Bank Policy Institute
Consumer Bankers Association
Credit Union National Association
Independent Community Bankers of America
National Association of Federally-Insured Credit Unions
National Bankers Association
Subchapter S Bank Association

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May 24, 2021

U.S. Senate
Committee on Finance
Dirksen Senate Office Bldg.
Washington, DC 20510–6200

The Honorable Sheldon Whitehouse
Chairman
U.S. Senate
Committee on Finance
Subcommittee on Taxation and IRS Oversight

The Honorable John Thune
Ranking Member
U.S. Senate
Committee on Finance
Subcommittee on Taxation and IRS Oversight

American Citizens Abroad, Inc. appreciates the opportunity to submit this statement for the "Closing the Tax Gap: Lost Revenue From Noncompliance and the Role of Offshore Tax Evasion" hearing held on May 11, 2021.

American Citizens Abroad, Inc. (ACA) appreciates the opportunity to submit this statement to the Committee. This statement benefits from our having listened to the hearing before the Subcommittee on Taxation and IRS Oversight on April 11th and reading the written statements of witnesses, as well as the opening statements of Chairman of the Subcommittee Senator Whitehouse and Ranking Member Senator Thune. We have also reviewed the statements submitted by others to the Committee.

By way of introduction, ACA is a qualified section 501(c)(4) non-profit membership organization, which advocates on behalf of Americans abroad. Its sister organization, American Citizens Abroad Global Foundation (ACAGF), is a qualified section 501(c)(3) tax-exempt public charity, which identifies subjects that affect Americans abroad, develops information about these subjects and provides this information to Congress, Treasury Department and other relevant persons.

ACA and ACAGF (collectively, ACA) favor a balanced approach to subjects, supporting efforts that can provide tangible results and practical solutions. ACA is the premier thought-leader on issues affecting Americans abroad. It is the largest Washington, DC-based organization of its type. Its membership base is overwhelmingly long-term American residents overseas. Members live in approximately 70 countries around the world. The profiles of these individuals are very similar to those of individuals of the same economic stratum and age living full-time in the U.S.

Among other things, ACA maintains the ACA Expat Tax Services Directory, which lists expat tax preparers (including firms focusing on FATCA compliance, streamlined procedures, and exempt organizations, charities and foundations), expat financial services providers (including those working in the fields of estate planning and pension and deferred compensation plan), and expat legal services providers (including firms specializing in voluntary disclosures and whistleblower cases).

ACA, together with the State Department Federal Credit Union, facilitates the quick and easy opening of US bank accounts for its members around the world. These accounts are the same as the accounts owned and operated by individuals working at US embassies and consulates. They are federal credit union accounts very much like the federal credit union accounts enjoyed by individuals working on Capitol Hill and at the Treasury Department and IRS. These accounts make it easier for expat Americans to pay taxes, receive tax refunds, receive special payments, like the Economic Impact Payments (variously called CARES Act or COVID–19 payments), and receive Social Security payments.

On the subject of closing the tax gap as it relates to individuals and activities outside the United States and revenue lost due to noncompliance and "offshore tax evasion", ACA has two big points to make.

First, good data and other information are critical. When attacking the problem of tax noncompliance involving individual US citizens, their entities and their activities and assets associated with these persons and activities, which assets are secreted outside the United States, great care must be taken in first uncovering all the facts. No one doubts that there is a significant amount of noncompliance and hiding of assets. It is remarkable, however, that Treasury Department and the Internal Revenue Service do not have complete or near complete information on the subject. If we do not know the facts and we start making changes, it is likely that we will miss things and, of great concern to ACA, that we will do harm to regular, compliant, well-meaning Americans abroad. We know these people because they are our members. We communicate with them every day. We help them with their everyday problems, including such things as dealing with the IRS electronically, getting a tax ID number (Social Security number), opening and maintaining a bank account where they live—outside the US, keeping a US bank or other financial account with a US institution, and finding a competent tax return preparer.

It is remarkable that the US government does not have reliable figures for the size and shape of the "offshore" element of the tax gap. Also, and this is of particular interest to ACA, it does not know the number of non-filers, and those otherwise out of compliance, who are resident abroad. All of us would like to know how much of the problem, which we are focusing on here, is traceable to individuals truly residing abroad, as opposed to individuals living in the U.S. and doing all manner of things to evade tax.

The problem at hand cannot be dealt with until we have complete information. Americans abroad should not be made to suffer because some bad actors are, frankly, cheating "like all get out".

ACA and ACAGF, it should be noted, undoubtedly have the best, most complete sets of private baseline data relevant to the taxation of Americans abroad, outside those in the files of the Joint Committee on Taxation and the Office of Tax Analysis. With District Economics Group, over an 8-month period in 2017, developed an analysis of a basic Residence-Based Taxation (RBT) proposal. ACA/DEG do not have access to tax return data other than what is published. We do, however, have information and insights not available to others, due to the fact that we and our members are immersed in the real-world experiences that yield the data. For example, what is the situation with Americans in the border communities between the US and Mexico and US and Canada? Also, we are very aware of the issues and practices arising with US taxpayers using the services of tax preparers and other advisors listed in our Directory. For example, how many people discover they are out of compliance and, for whatever reason, do not make a disclosure? How many people renounce US citizenship and, apparently, from all appearances, do not “catch up” and pay taxes owed either willfully or because they were unaware?

Incidentally, the aforementioned ACA-funded DEG analysis[1] of revenue effects of enactment of a “vanilla” version of RBT did not account for additional federal income taxes that might be paid by the nearly 2 million persons who are resident overseas who currently do not file income tax returns.

If the Committee or others have questions, just call us. We are happy to try to help. We have already had a large number of meetings on this subject and look forward to having more.

Secondly, while at first glance this might seem to be counterintuitive, the key to cleaning up the “offshore” element of the tax gap is enactment of Residence-Based Taxation as a replacement for the current Citizenship-Based Taxation.

With RBT, Americans truly resident outside the US would no longer be taxed on foreign, *i.e.,* non-US, income. This approach is the same used by every other country in the world with the exception, generally speaking, of Eritrea. It is the corollary of the approach, referred to as territorial taxation, applied to US companies. Big changes were made in the taxation of US companies on their foreign income in 2017, in the Tax Cuts and Jobs Tax Act. The Administration and Congress may, to some extent, make additional adjustments very soon. The treatment of individuals was completely—100%—ignored at the time of passage of TCJA. ACA begs Congress not to repeat this very unfair treatment.

Moving to RBT can help narrow the tax gap attached to individuals’ activities and presence abroad. It can throw light on the size and nature of assets belonging to Americans and located outside the US, including in zero tax and low tax jurisdictions. Having RBT in place could help separate out compliant, regular Americans residing abroad from non-filers and nervy—some would say foolish—people who simply walk away from the US self-assessment system, without looking back. Regular American expats who bring themselves within the RBT system would no longer pay US tax on foreign income. They would remain in the system and still file a greatly simplified form. Of course, they would remain US citizens. RBT is a significant benefit which essentially is aimed at “Long-Termers” living abroad. To get the benefit, you would have to be, or get, compliant. New-to-foreign-residence (“Newbies”) might be subject to special rules to avoid large revenue losses. People wanting to pay no tax anywhere would be cut off; no “zero tax” outcomes would be allowed under RBT. People resident in zero or low tax countries would not qualify; and these countries would be incentivized, in a bunch of ways, to exchange information. RBT can be made revenue neutral—no harm to the U.S. fisc—and tight, tight, tight against abuse.

RBT fits within the global system of taxing individuals. It would help the adoption by other countries and international organizations of measures facilitating the taxation of offshore accounts.

It would be the single most helpful step to relieve Americans abroad from double taxation and ridiculously complex and expensive reporting. All of the FATCA-related paperwork could be eliminated. Americans living normal lives outside the United States would no longer be viewed as financial lepers.

We want to emphasize that RBT can be made revenue neutral, tight against abuse and such that no one is worse off than they are under the current rules.

The drafting of amendments to the Internal Revenue Code to effect RBT is not especially difficult or tricky. Because the population of qualifying American citizens abroad would be treated similar to nonresident alien individuals under existing law, most of the statutory language is already in the Internal Revenue Code. For a “leg up” on statutory amendments, see “Side-By-Side Analysis: Current Law; Residency-Based Taxation”.

Thank you for your attention to this important subject.

Marylouise Serrato Executive Director—ACA	Charles Bruce Legal Counsel—ACA and Chairman—ACAGF

[1] *https://www.americansabroad.org/media/files/files/dc1e1c4e/DEG_short_memo_on_RBT_proposal_11.06.2017.pdf?utm_source=congress&utm_medium=email&utm_campaign=RBT%20fundraising%20campaign.*

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May 25, 2021

U.S. Senate
Committee on Finance
Dirksen Senate Office Bldg.
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The Association of Americans Resident Overseas (AARO) is a Paris-based Association representing more than 1,000 American members living outside the United States. We welcome the opportunity to comment on administration plans to raise large sums by reducing the $381-billion net "tax gap" (14.2% of "true taxes owed"). We understand that the IRS will likely revise upward its estimate of the tax gap, in part due to the large role attributed to offshore tax evasion.

We fully appreciate the need to modernize computing and information systems at IRS, something which AARO agrees should have been done long ago.[1] We also strongly urge that some of the large budgetary increases planned for the IRS be used to fund major improvements in taxpayer services accessible to overseas Americans. These include the creation of a dedicated division whose mandate includes providing customer service to taxpayers outside the U.S., online accounts, videoconferencing, facilitating payments both to and from IRS and use of foreign languages.

At the same time, the substantial increase in funding for the IRS proposed by the administration of around $8 billion per year for the next decade (an increase on the order of 60–70%)[2] raises a concern that, if its use is not properly structured, it may prove to be wasteful or even damaging. The emphasis on presumed but unidentified offshore evasion is particularly worrying to AARO given the problems existing enforcement efforts, relying heavily on foreign banks, have created for Americans overseas trying to access their local financial system. Rapidly diminishing returns to increases in expenditures seem inevitable, even given careful design of new enforcement measures.

The administration is targeting very high-income people assumed to be skilled at large-scale evasion, especially offshore. No one is deliberately targeting ordinary expats whose demographics and financial means are much like those of domestic American taxpayers across the entire socioeconomic scale. But our experience is that legislation and regulations are too often rushed and/or designed without consideration of their harsh, usually unintended, real-world impact on non-resident citizens. Recent examples include the deprivation of local bank accounts due to application of the Foreign Accounts Tax Compliance Act (FATCA); abusive and arbitrary resort to passport suspension and revocation; punitive tax penalties for small American businesses located outside the U.S. under the 2017 tax law's Transition Tax; and the levy on Global Intangible Low-Taxed Income (GILTI) are recent examples.

We have seen the IRS submission for this hearing and have obtained the research it released though the National Bureau of Economic Research (NBER).[3] This describes the methodology it has used in the past for calculating tax gaps as well as its basis for new estimates that will reflect an offshore component. A virtue of the NBER paper is that it includes clear, transparent and robust evidence-based analysis, derived mainly from the large National Research Program (NRP) of random audits:

- Income underreporting is 4% of the total, and the related tax deficiency is 7.7%.

[1] *See* the various Annual Assessments of IRS' Information Technology Program by the Treasury Inspector General for Tax Assessment (TIGTA) and reports from the Government Accountability Office (GAO) such as "Identity theft: IRS Needs to Strengthen Taxpayer Authentication Efforts" [GAO–18–418]; and "Information Technology: IRS Needs to Take Additional Actions to Address Significant Risks to Tax Processing" [GAO–18–298].

[2] For comparison, IRS resources in the Continuing Resolution for FY 2019 were $11.2 billion from appropriations ($4.7 billion for enforcement) plus $1.1 billion from other sources, mainly user fees.

[3] Guyton, J; P. Langetieg; D. Reck; M. Risch; and G. Zucman (2021), "Tax Evasion at the Top of the Income Distribution: Theory and Evidence". NBER Working Paper 28542, *http://www.nber.org/papers/w28542*.

- Just under 40% of this tax deficiency is owed by the top 10%.
- The total "net" tax gap (*i.e.,* taking all types of federal tax into account, net of enforcement and late payments) was around $193 billion p.a.[4]
- Adjusting for growth and inflation since 2012 yields a current estimate around $282 billion.

We are still digesting this work, but the gap between these numbers and more widely reported headline figures running to $1 trillion[5] seems to consist almost entirely of "adjustments" that are at best highly speculative guesswork. We can find little basis in evidence for these "adjustments," labelled variously "less sophisticated" and "sophisticated" evasion ("sophisticated" includes the offshore component, as well as evasion by many small businesses). Hopefully the referees who peer-review this work will be well-versed in international banking analysis and provide guidance to assist IRS toward well-targeted and realistic deployment of its coming resource increases.

While IRS methodology may be deemed the gold standard internationally, as the IRS submission states, other countries also prepare useful estimates of their own tax gaps. Notably, the latest tax gap reported by HM Revenue and Customs (HMRC) for the United Kingdom was 4.7% of "tax liabilities".[6] This is just ⅓ of the 14.2% U.S. net tax gap. Offshore evasion plays no explicit role in the analysis, and evasion attributed to the "wealthy" is below levels suggested by NRP audits, *i.e.,* even before "adjustments", in the United States.

This raises the question as to why the tax gap is so much lower in the United Kingdom? One possibility is that the tax system is simpler and more coherent and allows better coverage of tax bases by easily administered collection points and third-party reporting. In this case the solution to the tax gap is not more enforcement but major tax reform. Another possibility is that HMRC carries its duties out more efficiently than does the IRS, in which case the IRS might usefully learn from its British counterpart. The third possibility is that the difference lies in the respective capacities and methodologies of the two agencies for measuring tax gaps, in which case one should be able to learn from the other. Investing $20,000 for an independent expert to review IRS methodology, report on the reasons for the much smaller British tax gap and suggest lessons that can be drawn might be a good use of government money before $80 billion are deployed to mine an uncertain tax gap.

Finally, as noted above, there has been a long track record of hasty legislation and poorly targeted rules that have inadvertently done great damage to American citizens who happen to live overseas. AARO strongly urges the IRS (and its congressional overseers) to take care to ensure that the rules and procedures to be used by the IRS, especially where it targets offshore evasion, be subject to far more careful and meaningful regulatory impact assessments than have been carried out in the past. Unintended assaults on large numbers of compliant, law-abiding, working class, middle class and retired Americans who are not part of the top 1%, as well as small businesses, must be avoided.

AARO is available to Finance Committee members and their staff, and would welcome the opportunity, to elaborate on any of the citations or commentary provided above.

Thank you for your attention.

Paul Atkinson
Chair, Banking Committee

Fred Einbinder
Vice-President, Advocacy

[4] The $381-billion total "net gap" estimate is for 2011–13. The NBER study covers 2006–13 but describes the numbers relating to underreporting in the two studies as "essentially identical" (p. 9). On this basis, we proceed on the basis that we can adjust the former on the basis of adjustments to the latter alluded to in our following paragraph.

[5] Including the 2011–13 $441-billion gross and $381-billion net tax gaps, the estimate that the gap had risen to c. $600 billion in 2019, all cited in the IRS submission, and Commissioner Rettig's widely reported testimony to the Senate Finance Committee in April.

[6] "Measuring Tax Gaps, 2020 Edition", HRMC. *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/907122/Measuring_tax_gaps_2020_edition.pdf.* See p.5 for a summary.

William Jordan
President

LETTER SUBMITTED BY CODY GENTRY BARROW

U.S. Senate
Committee on Finance

Sir/ma'am,

I am an American citizen living in The Netherlands, effective August 2019. I vote in the State of Massachusetts because it is my most recent U.S. residence. I spent most of my career prior to moving abroad in Virginia. I believe my profile is unusual among individual submissions from Americans abroad you may receive, as I will explain below. It is certainly extraordinary for an individual with my security clearance [1] and government service experience to permanently reside abroad as a private citizen and express this level of concern with our nation's extraterritorial policies. I ask you and your staff members take my statement seriously as someone who served more than half his adult life to this nation.

As you know, the United States is the only developed nation in the world that taxes its citizens based on citizenship rather than where they reside and work. As a lifelong American patriot who has simply elected to work for a Dutch company and permanently reside abroad in the "second act" of his life, your committee's inattention to extraterritorial taxation and citizenship-based taxation issues has caused this military and intelligence veteran extreme and unnecessary financial distress. These issues also reflect poorly diplomatically with our Allied partners, including the Kingdom of the Netherlands, struggling with "accidental Americans" and the undue hardships placed upon U.S. citizens abroad due to FATCA and PFIC laws' unfortunate inadequate accounting for individual citizens pursuing middle-class lives.

For background, I am a former senior grade intelligence officer (GG/GS–14) and military veteran with experience in Afghanistan countering Taliban information operations on behalf of United States Cyber Command, of which I am a plank-holding (founding) member; the National Security Agency; and the Pentagon, where I worked with the Office of the Undersecretary of Defense for Intelligence, the Office of the Secretary of Defense for Policy, and was responsible on behalf of the Defense Intelligence Agency for strategic information operations program policy and special operations programs in direct engagement with the Secretary of Defense and in some cases the President, at the time President Barack Obama. You may also find several of my publications with the government/intelligence/academia think tank, the Intelligence and National Security Alliance (INSA), in the footnotes.[2, 3]

As you can imagine, this makes it all the more painful and excruciating that U.S. extraterritorial taxation policy has placed me in the highly unusual position of tax advisors suggesting I consider "unthinkable" options, such as citizenship renunciation, simply to pursue an ordinary life with a retirement plan, investment options in standard vehicles like ETFs, and other norms afforded to other American citizens without the extreme duress placed upon citizens abroad because of PFIC, FATCA, and other rules that classify middle-class individuals abroad as second-class citizens. This of course is not the course I will take. My intention is to remain an American citizen and to work through my elected officials to make our policies fair to Americans. It is always possible I will return to the U.S., my home country, and I should not be in a position of tax advisors suggesting I consider permanent separation simply to experience a normal life while residing abroad.

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[1] Between 2004 through approx. 2020 I held a Top Secret—Sensitive Compartmented Information (SCI) security clearance with Single Scope Background Investigation adjudicated by the Defense Intelligence Agency (DIA), National Security Agency (NSA), and United States Air Force (USAF), including full-scope and counterintelligence polygraphs adjudicated by NSA. I was additionally responsible for Special Access Program and Special Access Required compartmented programs and indoctrinated into numerous such compartments, some of which were otherwise exclusive to Agency directors and Senior Executive Service personnel.

[2] *Please see* my 2018 publication, *Getting Ahead of Influence Operations,* coauthored with the former Director of the National Security Agency and former Deputy Director of the Central Intelligence Agency, here: *https://www.insaonline.org/getting-ahead-of-foreign-influence-operations-may-2018/*.

[3] *Please see* my other publication, *A Framework for Cyber Indications and Warning,* coauthored with other industry leaders and former intelligence officials here: *https://www.insaonline.org/a-framework-for-cyber-indications-and-warning/*.

I assure this honorable committee that no American ever fled to Europe to evade taxes. European tax rates are among the highest in the world, including in wealth and capital gains unprotected from any double taxation exemption treaty, which is yet one more reason why U.S. citizens ought not be taxed both by their adopted nation and their home nation.

Here are some of the issues faced with citizenship-based taxation instead of residency-based taxation:

- Each treatment of U.S. citizens' abroad bank accounts, pensions, and other ordinary tenets of a healthy financial life are treated as "foreign" by the Internal Revenue Service (IRS), but for us these are **local** institutions. The United States's highly irregular and unique citizenship-based taxation system inadequately accommodates American citizens permanently living abroad.
- **PFIC** regulations similarly classify U.S. citizens' investments as "foreign," levying an extreme tax on middle-class Americans simply trying to invest in *local* equities, either for retirement or in the hope of improving their situation with capital gains investments. We cannot even invest in exchange-traded funds (ETFs), because European-based ETFs are classified as "foreign"—they are local to us—and local institutions will not allow investment in U.S.-based ETFs.
- The 2014 **FATCA** law, well-intentioned to prevent tax evasion and schemes, is a crushing regulatory burden on ordinary Americans. Foreign institutions are not willing to conduct business with middle-class U.S. citizens solely because of the burden levied here.
- U.S. tax treaties and policies to help prevent double taxation like **FEIE** and **FTC** are ineffective and incomplete. They have capped wage limits too low for professionals working and paid in Euro currencies and in professional fields. While my earned wage income may be higher than median, I am also taxed at a 49% rate by my country in Europe and I am paid at the market rate for a cybersecurity professional—my industry after leaving the government. I am not, nor likely ever will be, "wealthy" or a "fat cat." I am a working cyber intelligence professional. I am simply taxed twice, unlike any of my colleagues who are citizens of other developed nations—they are taxed based on where they reside and work, not based on their passport.
- Not in my case, but in other cases many American citizens have not been to the U.S., or in some cases have never been to the U.S., in many years. Many do not have any ties to the U.S. They do not have employment in the U.S. Yet the U.S. taxes them based on their passport, leading to a painful stigma against U.S. citizenship and resulting in more "burden" than gift. This is especially painful for me to witness as a former servicemember.
- This has led to an increasingly negative diplomatic image [4, 5, 6] for the United States through what has become "Accidental Americans," who contend with citizenship-based taxation's unintended negative effects regularly.[7]

While U.S. citizenship brings global protection and diplomatic and it is a privilege to be a citizen of what is frankly still the greatest country on Earth, these diplomatic services are U.S. citizens receive no benefits, use no services, and pay double taxes based on their passport. Citizens of every other developed country—in fact, every country save the African dictatorship of Eritrea—pay taxes based only on where they reside and are employed.

There is simply no excuse for citizenship-based taxation and immense distress wrangling with the IRS each year for citizens that use no services and have no connection to the United States besides their passport.

There is no excuse for classifying home sales, investments, and other aspects of normal financial planning as "foreign" investments and incurring a 40% tax penalty that other American citizens do not endure. For U.S. citizens abroad, these are *local* investments.

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[4] *Dutch MPs call for action on accidental American bank accounts: https://www.dutchnews.nl/news/2020/11/dutch-mps-call-for-action-on-accidential-american-bank-accounts/.*

[5] *France's "accidental Americans" file new suit over bank refusals: https://www.thelocal.fr/20200706/frances-accidental-americans-file-new-suit-over-bank-refusals/.*

[6] *Accidental Americans Appeal FATCA in Luxembourg Court: https://www.law360.com/tax-authority/articles/1372690/accidental-americans-appeal-fatca-in-luxembourg-court.*

[7] *Why 'Accidental Americans' Are Desperate to Give Up Their U.S. Citizenship: https://time.com/5922972/accidental-americans-fatca/.*

These are local homes where U.S. citizens abroad have purchased homes to raise their families, just as Americans domestically, but we are subject to highly irregular "foreign" tax penalties simply because we hold U.S. citizenship.

These policies like PFIC and FATCA are well-intentioned and typically designed to prevent tax evasion, yet they have a severe effect of harming ordinary citizens while corporations and wealthy individuals find other ways to avoid taxes, such as leveraged borrowing. Neither the IRS nor the U.S. tax code acknowledges how much unnecessary burden these policies place on ordinary Americans who happen to live abroad. Many, perhaps most of these citizens have no affiliation with American employers or corporations in any capacity and are simply trying to live normal lives.

There must be a more fair and equitable solution that would identify how many days a citizen has worked in the United States, or has visited the United States, and incur tax liability only in such circumstances. I am certain all U.S. citizens would be happy to pay taxes when working for American employers, residing in the United States, or using American services, et cetera. As it stands, American citizens abroad are in a unique and the most situation possible among developed nations—hamstrung with retirement, investment, home ownership, and other options—merely based on our passport.

Americans should be proud of our passport, not afraid of how it will harm our futures or our families because of highly irregular tax policies. As well-intentioned as they may be, it is important to distinguish much more effectively between corporate entities evading taxes and individuals simply trying to live normal lives abroad.

Please feel welcome to reach out to me with further engagement.

Sincerely,
Cody Gentry Barrow
10 May 2021

LETTER SUBMITTED BY ANNE-MARIE YARBROUGH BUZATU

Dear Committee Members,

Imagine you were born in Canada, but moved to Texas as a young person, obtained U.S. citizenship and built your family life and career in Texas. You love your life in Texas, and you don't have plans to return to Canada, but there is one BIG catch: you have to pay higher Canadian tax rates on your income, often on top of the taxes you are already paying in the U.S., for services such as Canadian nationalized health care that you never personally benefit from, just because you were born there. You can't take advantage of U.S. tax programs such as 401K plans and education deductions because they are not "Canadian approved" programs, so you have to pay even higher taxes to Canada on the income the U.S. allows you to deduct.

Furthermore, Texas banks have to report all of your financial records to the Canadian tax authorities, and as a result very few banks will accept you as a client, so you can't shop around for a better mortgage or a higher savings interest rate. On top of this, jobs in which you would have bank authority or signatory power don't want to hire you even if you are the best candidate because the organization's financial information would have to be sent to the Canadian financial authorities.

Finally, you are effectively barred from investing in any kind of mutual funds or investment instruments in Texas because they are treated by Canada as "offshore" accounts overseen by the Canadian Financial Crimes Unit, with onerous reporting requirements and punitive tax rates. All of this because you were born in Canada, and because of your place of origin you are discriminated against/treated more punitively than other Americans—even those born in other countries who are living in the U.S. Then imagine that your repeated calls to change the system to something more equitable were systematically ignored by both Canadian and U.S. authorities.

Sound unfair? This is the reality I have to contend with every day as a "U.S. person" who has made my home in Switzerland.

I am an American citizen, born and raised in Texas, who has resided in Switzerland for more than 15 years, and who has recently obtained Swiss citizenship. Because of my status as a "U.S. person", I am discriminated against in Switzerland, my place of residence and now nationality, because of the U.S. practice of taxing "U.S. persons" on their worldwide income, the Foreign Account Tax Compliance Act (FATCA) and the bilateral agreement that the U.S. negotiated with Switzerland in order to enforce FATCA. Furthermore, because I reside outside of the U.S., I am discriminated against as compared to my U.S.-based compatriots and am unable to benefit from a whole host of social benefits, tax deductions, tax credits and banking services. Here are a few examples:

- I am **effectively banned from opening an investment account in Switzerland,** my place of residence and nationality, because financial institutions do not want to assume the onerous reporting requirements that come with a potential withholding fee of 30%.
- **Nearly all banks in Switzerland will not accept me as a client for regular banking services** for the same reasons, so there is no way for me to compare banking services or take advantage of offers that are not provided by the one bank that will accept me (UBS).
- **Nearly all U.S.-based investment firms and banks will not accept me as a client** because I am not a resident of the U.S.
- I pay into a **retirement fund that is very similar to a 401K program,** and which provides similar tax advantages in Switzerland because I am only taxed on that income when I take it out at retirement; but both my and the employer's contributions are taxed by the U.S. in the year I earn them meaning I am **taxed at a punitive rate.**
- **I cannot take deductions for my sons' university tuition** because they schools they go to are not on the U.S. Department of Education's Database of Accredited Post [1] Secondary Institutions and Programs (DAPIP) or the Federal Student Loan Program list.[2]
- I am **not able to benefit from** a whole host of **tax deductions and credits that my U.S.-residing compatriots do** because I am not a resident of the U.S.
- **Many IRS services are only available to U.S. residents,** meaning that they are not available to me as a U.S. person residing abroad.
- **Being a "U.S. person" has impacted me professionally** because any Swiss institution I work and have bank signatory rights for would have to have their finances reported to the IRS. **I have only worked for non-profit NGOs in Switzerland.**
- In many cases **Swiss taxes are assessed in a manner that is fundamentally incompatible with the U.S. income tax** approach, meaning that in some cases I am double-taxed by both systems; the current U.S.-Swiss tax treaty does not effectively address these inconsistencies (see more below).

U.S. taxation on my and my husband's incomes is disastrous for us, for numerous reasons which are laid out in detail in the below submission. However, before wading into the weeds, I wanted to put up front my recommendations for how to overhaul international taxation so that it is fairer and reduces discrimination against folks like myself:

(1) **Change the system of citizen-based taxation of individuals to** that of individual taxation on only income earned from U.S. sources, and not worldwide taxation, also known as **resident-based taxation for individuals,** the kind of income taxation that most of the rest of the world practices (for a relatively simple and fast interim fix to this issue by the U.S. Treasury while waiting on lengthier legislative processes, please read this article);[3]

(2) Create a **special committee that looks at the impacts of U.S. taxation on its nationals residing abroad** so that any changes made to the tax code are reviewed by this body to ensure that our situations are taken into consideration, including analyses of how they are (in)compatible with the tax systems of the other 190+ countries in which U.S. persons live in order to protect against unintended negative consequences; and finally

(3) Include **formal representation of Americans living abroad** in our representative bodies, as the approximately 9 million of us living abroad need a voice. Switzerland and France include seats for their citizens residing abroad in their Parliaments, and the U.S. can and should do the same.

To understand why I am making these recommendations, please read the more personal account below.

I was born and raised in Texas, where I lived most of my life until I and my family moved to Switzerland more than 15 years ago. We didn't feel we had much choice.

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[1] *https://ope.ed.gov/dapip/#/home.*

[2] *https://studentaid.gov/understand-aid/types/international.*

[3] *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3795480&fbclid=IwAR10eXmPraGW3Wuaa_VgnL7HYObjUBZz3302cglQOsT2rPyxtmy5SS7ibgU.*

In August 2005, my husband was laid off from his job in the high-tech sector. We had two young boys aged 4 and 7, and I was working as a part-time consultant and a more than full-time mom. Once my husband lost his job, we suddenly were faced with extremely high health insurance costs (COBRA), significant student loan debts and a high monthly rent with no income. My husband applied for several jobs and had a few interviews, but the offer that he got was working in IT for the International Computing Center, a UN-affiliated computer services organization, located in Geneva, Switzerland.

In Switzerland, I went back to school studying the impact of war and on international security and human rights. I subsequently managed to carve out a really fulfilling career working for Swiss-based NGOs where I strive to limit the negative impacts of businesses on human rights, as well as work with the private sector to foster positive change, both on the ground as well as in the halls of international policy.

I love the U.S. and have close ties with family members and several good friends who live there. Both of my elderly parents are alive but have been experiencing some serious health issues of late. Before the pandemic, I typically would visit them at least once a year, and it has been tough waiting on the sidelines, hoping that I will be able to see them again before too long. It is important to me that I am able to visit them, and to be able to spend more time with them should they need extra care and support, and more generally I love getting back to the U.S. There are definitely things that I miss, like really good Tex-Mex (!) in an affordable restaurant, infinite sunsets over a West Texas sky, and easy, laid-back conversations with good friends and family.

What I do not love is the U.S. taxation of people like me who live, work and pay taxes in a completely different tax system, which in many areas is completely incompatible with the U.S. tax system. As a matter of fact, you could say that the U.S. has three different distinct income tax regimes which creates different, unequal classes of taxation: 1. Residence—For U.S. residents, 2. U.S. Source—For non-resident aliens, 3. Extraterritorial—For Americans Abroad. This last regime to which I and my family are subject means that we don't get the same kinds of deductions and tax credits as our homeland-based compatriots. For example: I participate in an employer-contribution retirement program which is very similar to U.S. 401K programs: the employer matches my contributions, and I do not have to declare the employer nor my contributions on my Swiss taxes as they are paid, only when I take them out after retirement when I am likely earning much less. However, the U.S. taxes me on the employer contributions as well as my own contributions to the tax plan *in the year that they are paid,* so I am taxed by the U.S. on money I haven't even received, and likely at a higher tax rate than I would be at during retirement. Another example: my son is going to a university located in Berlin, Germany, however the school is not on the list of U.S. recognized educational institutions, so we are unable to deduct his tuition from our taxes.

Furthermore, Swiss income taxes are structured completely differently from those of the U.S., and they are in most cases lower than the U.S. income tax rates. However, the cost of living in Switzerland is one of the highest in the world and is considerably higher than we were paying in Texas. People who visit from the U.S. are shocked at the prices in the stores and restaurants here, and renting/buying homes is extremely expensive. However, because of the relatively high salaries (in Geneva we have an appx. $25/hour min wage) and low taxes, these prices are generally affordable to people who work here. Less so for us: as "U.S. persons", because we are unable to take many of the same deductions as our homeland compatriots, we essentially have to pay higher U.S. taxes than Americans living in the U.S., higher taxes than others who live and work in Switzerland and pay the higher Swiss prices. And to be very clear, we are not earning very high salaries, but rather are at that sour spot of earning just a little more than the Foreign Earned Income Exemption (FEIE) once things like our employer contributions to pensions and other benefits—much of which we don't get in pocket—are taken into account. As such, we pay U.S. taxes at a pretty high rate on income that doesn't make it into our bank account and given the high cost of living we have here, this means we are penalized financially relative to our colleagues who are working similar jobs.

Moreover, as U.S. persons residing abroad, we are not able to take advantage of many of the tax credits that are available to those living in the U.S. For example, in March 2018 we bought a Tesla Model 3 (the more affordable Tesla) and were under the impression that we would be able to get the $7,500 tax credit to help us offset the still significant cost. However, when we did our U.S. taxes, we learned that this tax credit was only available to those actually living in the U.S., not those living abroad. In a way I understand the rationale: our Tesla would not be directly benefitting those living in the U.S. (although it is contributing to an overall globally cleaner environment), and therefore we should get no incentive from the U.S. to buy it. However, by the same logic, we should not be paying taxes in the U.S. on income that we do not earn from there, to pay for an infrastructure and a Congress that does not directly benefit or represent us.

Coming back to the incompatibility between Swiss and U.S. income tax systems, this is not just limited to the fact that similar Swiss retirement and education tax programs are not recognized by the U.S., but also to completely different approaches in the manner of calculating income tax. For example, in Geneva the way that taxes are assessed in relationship to our townhouse is that the income tax authorities tax us on the fictional "income" we would have earned if we had been renting the house out (which we are not). The way they calculate this is very complicated and not fully known to me, but it has something to do with the type of property, when the property was built, where it is located, and the amount of income that we earn from our work (this last element helps to ensure that we will not be priced out of our home by property taxes even as property values rise). Furthermore, it is something we find out long after the fact of filing taxes. For example, for tax year 2020, we will file our Swiss tax returns in June of 2021 and we will get the calculation of this "income tax on our property" somewhere in October–November 2021, long after our U.S. tax returns are due and interest is being assessed on any unpaid amounts. Furthermore, its incompatibility with how U.S. assesses income and property taxes makes it really difficult to know how to include that in our tax returns. We tried to do it for a couple of years, but this did not seem to be accepted by the IRS, and then we had to pay additional taxes with penalties and interest. Now we do not even try to include these taxes we pay on our U.S. tax return, and so we are being double-taxed by both Swiss and U.S. jurisdictions on that income.

When it comes to trying to get information, help and guidance from the IRS so that we can navigate these difficulties more easily, this is also not set up for those of us living abroad. Most of the time when I call the IRS, I get a message that the line is too busy and they are not accepting calls at that time. Sometimes I have gotten a message saying that the estimated wait is between a certain time, such as 7 to 10 minutes, and then finally hung up after being on hold for more than 30 minutes. Needless to say, there are no toll-free numbers for U.S. persons abroad, so of course we have to pay international long-distance rates. However, even many of the IRS online services are not available to those of us living outside of the U.S. (see below for an example).

Another problem is that as "U.S. persons", nearly ALL banks will simply not open an account for us, which has huge implications on, for example, shopping for affordable mortgages from local/cantonal banks.

Further, we are effectively banned from investing in any kind of stocks, bonds or mutual funds in our country of residence *and* nationality. We are getting older, and we wanted to try to invest in a mutual fund here to put aside a little extra money for our golden years. However, the only bank we found in Switzerland that would accept us as customers had a 250,000 Swiss Francs (about $270,000) minimum investment requirement—something that is definitely out of our league! Furthermore, we learned that even if we could and did invest in a mutual fund here in the country where we live (and now are also citizens of), that it would be treated by the U.S. as a "Passive Foreign Investment Company" and would be taxed at an exorbitant rate.

Discrimination against me as a "U.S. person" has also impacted me professionally. After I was hired as the COO for a very small, non-profit Swiss NGO we learned that if I were given signatory rights on our organizational bank account, that the financial records of this Swiss organization would have to be sent to the IRS. Therefore, I do not have these rights, and I can't perform all of the functions of my role. This puts me at a disadvantage employment-wise relative to all of the qualified candidates who do not have U.S. citizenship.

Furthermore, filing and paying taxes in the U.S. is extremely complicated, and calculations/corrections made by the IRS are not transparent. We have consistently filed and tried to pay our taxes in accordance with the rules as we understand them, although the tax code is not exactly straight-forward especially for people like us living outside the U.S. Sometimes we get bills years later without any explanation as to why or how new calculations were made. For example, we recently got a bill from the IRS from 2014 for nearly $8,000(!) This is a lot of money for us. I wrote the IRS and asked for an explanation of how they calculated this amount more than six years after the fact and got no response except for a threatening letter that they are going to levy taxes on our assets. I tried to go online to get a transcript of how they calculated this tax, however the online service is not available to persons who live abroad! There is a phone-in/write-in service to obtain tax transcripts, but it only goes back to the previous three years' returns. I tried to call anyway and was not able to get through.

I am not against paying taxes, and fully recognize the necessity of them. If I were to earn any money from U.S. sources, it would make sense that I pay U.S. tax rates under the U.S. tax system, but not that I pay Swiss taxes on top of them. If every country taxed because of nationality (or even former permanent residence status) with no regard to the other nationalities and their accompanying tax systems, the impacts would be devastating: many persons here in Geneva have 3, 4 or even more nationalities, and having to satisfy the requirements of multiple different, incompatible national income tax systems on income earned in one country would not be sustainable, nor would it be fair. In this respect the U.S. is the only country (outside of Eritrea) that taxes on the basis of nationality/permanent residence, but this also highlights how incongruent and out of step this practice is with the rest of the world, and for its citizens/permanent residents who happen to reside in other countries. Every time Congress makes a change to the tax code, this directly impacts me and those of us living outside of the U.S. who are also subject to other tax code regulations. However, these impacts are rarely if ever discussed by members of Congress, and certainly not studied in depth as to how they will impact/interact with the other 190+ countries' income tax regimes where U.S. persons may be living. This results in devastating unintended consequences on ordinary folks: if I were rich, or a multinational, I would have the resources to figure out how to get around the different tax systems, but I am not.

Finally, I cannot express the anger and frustration I feel when I read that Amazon and 54 other major U.S. corporations, as recently reported in the *NY Times,*[4] paid ZERO income taxes on incredible, record-setting profits in the many billions. How is it that we, a middle-class family who hasn't even lived or earned any income in the U.S. for more than 15 years, are effectively paying more income taxes than Amazon?

Therefore, we ask you to:

(1) Change the system of citizen-based taxation of individuals to that of individual taxation on only income earned from U.S. sources, and not worldwide taxation, also known as **resident-based taxation for individuals,** the kind of income taxation that most of the rest of the world practices (for a relatively simple and fast interim fix to this issue by the U.S. Treasury while waiting on lengthier legislative processes, please read this article);[5]

(2) Create a **special committee that looks at the impacts of U.S. taxation on its nationals residing abroad** so that any changes made to the tax code are reviewed by this body to ensure that our situations are taken into consideration in such regulation and to protect against unintended consequences; and finally

(3) Include **formal representation of Americans living abroad in our representative bodies,** as the approximately 9 million of us living abroad need a voice. Switzerland and France include seats for their citizens residing abroad in their Parliaments, and the U.S. can and should do the same.

We should not be penalized and discriminated against just because we were born in, had American parents or lived a significant time in the U.S., and reside in another country. Furthermore, we can be an important resource to the U.S.—we can play the role of "local ambassador" in our countries of residence, helping to bridge differences and forge understandings between the U.S. and the countries we call home, which is increasingly important in our highly interconnected, shrinking world.

As a last note, it is more than somewhat ironic that the U.S. ostensibly got its start over a tax dispute with its overseas colonial parent, with American revolutionaries crying out the slogan "no taxation without representation," launching a war that brought about the birth of our nation, and yet it taxes folks like me who earn their

[4] *https://www.nytimes.com/2021/04/02/business/economy/zero-corporate-tax.html.*
[5] *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3795480&fbclid=IwAR10eXmPraGW3Wuaa_VgnL7HYObjUBZz3302cglQOsT2rPyxtmy5SS7ibgU.*

income completely outside the U.S. system and have no effective representation on the U.S.-created impacts we face living abroad. That notion of justice, of democratic representation and fair taxation is fundamental to the very identity of the United States, and yet somehow it is the only developed country that burdens individuals such as myself with a tax imposition that does not take into account the situations in which we are living, and which prevents us from fully participating in the societies of which we are part.

Many have said that you, our representatives, don't care for U.S. persons residing abroad, that we don't matter enough in terms of votes or funding, that our situations don't play well on media platforms in terms of messaging, that we don't have enough pull or importance to get any attention. However, I am still hoping that you can care about something that is wrong and unfair, even if it isn't politically expeditious. In fact, it is my American-bred idealism and pragmatic, can-do spirit that make me believe that we can work together to develop an income tax system that is fair and not unduly burdensome, and that honors those fundamental American values which we all hold dear.

I thank you for your time and attention, and hope that this submission will be fully considered by the Committee. I would be happy to provide any additional information or support to help you better understand the implications of the U.S. income tax system on folks like me who live in other countries.

Sincerely,

Anne-Marie Yarbrough Buzatu

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Statement of Michael G. Bindner

Chairman Whitehouse and Ranking Member Thune, thank you for the opportunity to submit these comments for the record to the Subcommittee.

For additional context, see our comments submitted to the full committee on "How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment" on March 25, 2021.

The Administration has requested $80 Billion to enable the IRS to go after an estimated net gain of $700 Billion, or $780 Billion in gross collections. This sounds like a good deal. The only reason to oppose this is the belief that tax cheating is a civil right. Sadly, this may not be far from the truth. By all means, this money should be spent, as the scheduled witnesses will like affirm.

There is an easier way to recoup these funds while ending the requirement to file taxes for 97% of households who are not filing business taxes. Please see the attachment for more information on how this may be done.

Businesses would pay a subtraction VAT, with a first tier meant to fund the child tax credit, paid leave, childcare, health care, social services and education (including a state administered tax). Ideally, at the federal level, no revenue would be collected because employers would provide these services in lieu of tax payment.

Higher tiers of the subtraction VAT would collect taxes on salaries with a 6.5% rate on income over $85,000, with increments of that amount to a top rate of 26% starting at $340,000 in salaried income. Salary surtaxes, with an option to purchase tax prepayment bonds, would start at $425,000 at 6.5% to a top rate of 26% starting at $680,000.

A credit invoice value-added tax to fund what is now collected through the employer contribution to Old-Age, Survivors and Disability Insurance (credited equally for all workers) and discretionary military and civil spending in the continental United States.

Taxes on salaries can be collected by employers without having to file because taxes on capital income and gains would be funded separately. Rental and capital gains on real property would be collected by states and capital gains and income from financial assets would be collected by the federal government, with funds remitted by brokers or trading platforms directly to the Securities and Exchange Commission. Our proposed rate is 26%.

Sales of stock (publicly traded and privately held) to qualified Employee Stock Ownership Plans would be zero rated. Sales of real estate sold to ESOPs or cooperatives would be zero rated at the state level. Shares would be marked to market when information on sale prices is lost, when stock options are exercised and at the first sale after inheritance, gift or charitable donation. Self reporting will not occur, ending non-compliance due to strategic record keeping.

Parking money offshore to avoid taxes can be easily dealt with if we the desire to do so (see again my comments on tax cheating). Subtraction Value-Added and Credit Invoice taxes will pull in most revenue—both from labor and profit within the enterprise where the costs are incurred or the goods and services are provided. Even medical services provided remotely (as my last x-ray was) would be subject to tax.

This applies to headquarters location as well. Correspondence and revenue will be credited where the correspondence is opened and presented at the physical location of the home office. I am sure there are legislative drafters among committee staff who can iron out ironclad language. It is time to let them.

The biggest tax shelter is the use of money market funds to accumulate capital gains and income without taxation. This practice must end if salary surtaxes no longer include non-salaried income. 75% of such funds are held by the top 10% of households as measured by the 2019 Survey of Consumer Finance by the Federal Reserve. I suspect the other 20% are held by high income retirees. The working class will not be harmed.

This ratio affirms what Pareto found, except his ration was 80% of wealth held by 20% of asset holders. Clearly, things have gotten worse for the 80th to 89.9th percentile. *If you apply the Pareto rule to higher levels of income, and with Berkshire Hathaway there is no reason not to, the top 1450 households hold roughly 30% of all wealth in mutual funds.* This ratio also applies to bond holdings, but this is a topic for another day.

This finding also takes away the excuse used to shift retirement income from defined benefits to defined contributions. The only people who benefit more from such arrangements are brokers. The relationship between investment bankers, brokers and ratings agencies makes scenarios about how defined contribution reserve requirements are calculated suspect at best and likely unethical, if not criminal. This ranks up there with using inside information to make electronic trades. At least there, an Asset VAT of 26% should end this practice.

We have left a loophole on Asset Value-Added Taxes that some will be able to fly a 757 through, which is trading stock overseas to avoid taxation. The only way out of this is an internationally negotiated asset VAT rate, or at least the same range. This ends the need for a minimum tax on corporate income (note that corporate income taxes will be discontinued under this proposal).

Ending the mutual fund shelter and levying an Asset VAT gets at all of the income and gains that wealth taxes are proposed to capture, or rather, it limits the accumulation of gains and income that is currently sheltered. Indeed, doing so dwarves what Senators Warren and Sanders and Professors, Piketty and Zucman propose to collect with their Wealth Tax proposal. For more on my analysis of wealth taxes, see my comments to the Subcommittee on Fiscal Responsibility and Economic Growth hearing on "Creating Opportunity Through a Fairer Tax System" held on April 27, 2021.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

Attachment—Tax Reform, Center for Fiscal Equity, March 5, 2021

Individual payroll taxes. These are optional taxes for Old-Age and Survivors Insurance after age 60 for widows or 62 for retirees. We say optional because the collection of these taxes occurs if an income sensitive retirement income is deemed necessary for program acceptance. Higher incomes for most seniors would result if an employer contribution funded by the Subtraction VAT described below were credited on an equal dollar basis to all workers. If employee taxes are retained, the ceiling should be lowered to $85,000 to reduce benefits paid to wealthier individuals and a $16,000 floor should be established so that Earned Income Tax Credits are no longer needed. Subsidies for single workers should be abandoned in favor of radically higher minimum wages.

Wage Surtaxes. Individual income taxes on salaries, which exclude business taxes, above an individual standard deduction of $85,000 per year, will range from 6.5% to 26%. This tax will fund net interest on the debt (which will no longer be rolled over into new borrowing), redemption of the Social Security Trust Fund, strategic, sea and non-continental U.S. military deployments, veterans' health benefits as the result of battlefield injuries, including mental health and addiction and eventual debt reduction. Transferring OASDI employer funding from existing payroll taxes would increase the rate but would allow it to decline over time. So would peace.

Asset Value-Added Tax (A–VAT). A replacement for capital gains taxes, dividend taxes, and the estate tax. It will apply to asset sales, dividend distributions, exercised options, rental income, inherited and gifted assets and the profits from short sales. Tax payments for option exercises and inherited assets will be reset, with prior tax payments for that asset eliminated so that the seller gets no benefit from them. In this perspective, it is the owner's increase in value that is taxed.

As with any sale of liquid or real assets, sales to a qualified broad-based Employee Stock Ownership Plan will be tax free. These taxes will fund the same spending items as income or S–VAT surtaxes. This tax will end Tax Gap issues owed by high income individuals. A 26% rate is between the GOP 24% rate (including ACA–SM and Pease surtaxes) and the Democratic 28% rate. It's time to quit playing football with tax rates to attract side bets.

Subtraction Value-Added Tax (S–VAT). These are employer paid Net Business Receipts Taxes. S–VAT is a vehicle for tax benefits, including

- Health insurance or direct care, including veterans' health care for non-battlefield injuries and long-term care.
- Employer paid educational costs in lieu of taxes are provided as either employee-directed contributions to the public or private unionized school of their choice or direct tuition payments for employee children or for workers (including ESL and remedial skills). Wages will be paid to students to meet opportunity costs.
- Most importantly, a refundable child tax credit at median income levels (with inflation adjustments) distributed with pay.

Subsistence level benefits force the poor into servile labor. Wages and benefits must be high enough to provide justice and human dignity. This allows the ending of state administered subsidy programs and discourages abortions, and as such enactment must be scored as a must pass in voting rankings by pro-life organizations (and feminist organizations as well). To assure child subsidies are distributed, S–VAT will not be border adjustable.

The S–VAT is also used for personal accounts in Social Security, provided that these accounts are insured through an insurance fund for all such accounts, that accounts go toward employee ownership rather than for a subsidy for the investment industry. Both employers and employees must consent to a shift to these accounts, which will occur if corporate democracy in existing ESOPs is given a thorough test. So far it has not. S–VAT funded retirement accounts will be equal-dollar credited for every worker. They also have the advantage of drawing on both payroll and profit, making it less regressive.

A multi-tier S–VAT could replace income surtaxes in the same range. Some will use corporations to avoid these taxes, but that corporation would then pay all invoice and subtraction VAT payments (which would distribute tax benefits). Distributions from such corporations will be considered salary, not dividends.

Invoice Value-Added Tax (I–VAT). Border adjustable taxes will appear on purchase invoices. The rate varies according to what is being financed. If Medicare for All does not contain offsets for employers who fund their own medical personnel or for personal retirement accounts, both of which would otherwise be funded by an S–VAT, then they would be funded by the I–VAT to take advantage of border adjustability. I–VAT also forces everyone, from the working poor to the beneficiaries of inherited wealth, to pay taxes and share in the cost of government. Enactment of both the A–VAT and I–VAT ends the need for capital gains and inheritance taxes (apart from any initial payout). This tax would take care of the low-income Tax Gap.

I–VAT will fund domestic discretionary spending, equal dollar employer OASI contributions, and non-nuclear, non-deployed military spending, possibly on a regional basis. Regional I–VAT would both require a constitutional amendment to change the requirement that all excises be national and to discourage unnecessary spending, especially when allocated for electoral reasons rather than program needs. The latter could also be funded by the asset VAT (decreasing the rate by from 19.5% to 13%).

As part of enactment, gross wages will be reduced to take into account the shift to S–VAT and I–VAT, however net income will be increased by the same percentage as the I–VAT. Adoption of S–VAT and I–VAT will replace pass-through and proprietary business and corporate income taxes.

Carbon Value-Added Tax (C–VAT). A Carbon tax with receipt visibility, which allows comparison shopping based on carbon content, even if it means a more expensive item with lower carbon is purchased. C–VAT would also replace fuel taxes. It will fund transportation costs, including mass transit, and research into alternative fuels (including fusion). This tax would not be border adjustable.

Summary

This plan can be summarized as a list of specific actions:

1. Increase the standard deduction to workers making salaried income of $425,001 and over, shifting business filing to a separate tax on employers and eliminating all credits and deductions—starting at 6.5%, going up to 26%, in $85,000 brackets.
2. Shift special rate taxes on capital income and gains from the income tax to an asset VAT. Expand the exclusion for sales to an ESOP to cooperatives and include sales of common and preferred stock. Mark option exercise and the first sale after inheritance, gift or donation to market.
3. End personal filing for incomes under $425,000.
4. Employers distribute the child tax credit with wages as an offset to their quarterly tax filing (ending annual filings).
5. Employers collect and pay lower tier income taxes, starting at $85,000 at 6.5%, with an increase to 13% for all salary payments over $170,000 going up 6.5% for every $85,000—up to $340,000.
6. Shift payment of HI, DI, SM (ACA) payroll taxes employee taxes to employers, remove caps on employer payroll taxes and credit them to workers on an equal dollar basis.
7. Employer paid taxes could as easily be called a subtraction VAT, abolishing corporate income taxes. These should not be zero rated at the border.
8. Expand current state/federal intergovernmental subtraction VAT to a full GST with limited exclusions (food would be taxed) and add a federal portion, which would also be collected by the states. Make these taxes zero rated at the border. Rate should be 19.5% and replace employer OASI contributions. Credit workers on an equal dollar basis.
9. Change employee OASI of 6.5% from $18,000 to $85,000 income.

LETTER SUBMITTED BY JAMES WEBSTER COATES

Non-Resident U.S. Citizens Are Not "Fat Cats"—
Yet, We Are the Ones Impacted by FATCA

Chairman Whitehouse and members of the Subcommittee on Taxation and IRS Oversight:

I was disturbed by the insinuation behind Chairman Whitehouse's tax joke at the May 11th hearing, which implied that FATCA will reign in tax evading "Fat Cats." The pain caused by the extraterritorial application of U.S. income tax information reporting requirements falls primarily on the 8 million U.S. citizens who reside outside the United States. The great majority of us are not rich "Fat Cats." To the contrary, in a survey [1] of 1,564 overseas resident citizens conducted by Stop Extraterritorial American Taxation ("SEAT"), an independent, non-partisan not-for-profit association, 66% of recipients had annual income of less than $75,000 and 25% less than $25,000. Furthermore, 46% of participants agreed with the statement "I pay significant fees for preparation of U.S. tax return but owe nothing in U.S. taxes," with 41% of those who engaged a professional preparer paying more than $1,000 in fees.

This is a reflection of the burden non-residents face due to complex information reporting requirements related to ordinary banking, investment and pension products which are "foreign" to the United States but just a part of living an ordinary financial life in one's country of residence.

[1] *http://seatnow.org/survey_report_intro_page/.*

Beyond the reporting complexities which fall on non-resident U.S. citizens, we also face denial of service from financial institutions which do not want to deal with the compliance burden of IRS reporting now expected of Foreign Financial Institutions under FATCA. 41% of the respondents to the SEAT survey stated that "I have not been able to open one or more bank, retirement or other financial account."

As for myself, I am a U.S. citizen who has resided in Japan since 2001, and since the implementation of FATCA, have been denied service by one bank and two life insurance companies because I am a U.S. citizen. It is indeed quite ironic that the financial institutions which denied me service are subsidiaries of major U.S. firms.

This is a real hardship for non-resident U.S. citizens. U.S.-based financial institutions generally won't open accounts for us because we have no address in the United States, and the onerous and complex FATCA reporting requirements often cause financial institutions in our home countries to decline to do business with individuals who happened to have been born in the United States.

The topic of the May 11 hearing was supposed to be about "Fat Cats" and regaining Lost Revenue from Noncompliance and Offshore Tax Evasion, but I urge you to balance this perspective with the impact that FATCA and other federal tax programs have on ordinary law-abiding citizens who happen to reside outside the United States.

According to the SEAT survey, 80% "experience personal stress in relation to U.S. taxation," a large part of which is due to the constant sense of fear because of the excessive penalties that could be applied for making an honest mistake in our tax compliance. For example, for FinCEN Form 114, the Report of Foreign Bank and Financial Accounts (FBAR), the penalty for misfiling is the GREATER OF 50% of the maximum balance of the account in question or $100,000. For Form 8938, which is similar to, but different from the FBAR, the penalty is $50,000 per mistake. For Form 8621 which must be filed for non-U.S. mutual funds, the penalty is $10,000 per form per year. Imagine if you reported your mutual fund dividends on Schedule B of Form 1040 the same way U.S. residents do but didn't realize that you were actually supposed to report them as a "Passive Foreign Investment Company" on Form 8621. What if this happened to you for multiple mutual funds over a multi-year period? The penalties would be astronomical! Even if you are trying to be fully-compliant, you can easily get caught up in an issue like this.

I urge the Senate Finance Committee to hold a hearing focused on the difficulties U.S. citizens who reside outside the United States are facing in navigating the increasingly complex extraterritorial tax compliance regime that the U.S. imposes on its non-resident citizens. These issues are not well known or understood, but they are a tremendous burden on millions of ordinary people who happen to live overseas.

Despite the billions in dollars in compliance costs that the global financial services industry has suffered as a result of FATCA, I can't imagine that this regime will actually result in significant enforcement opportunities for the IRS. I faithfully report all of my Japanese financial accounts on my own tax returns (Form 8938, FBAR, Form 8621, etc.) but the majority of the financial institutions that do business with me have no means of grasping that I am a U.S. taxpayer and are therefore unable to make the corresponding disclosures to the IRS. In his testimony to the Committee, Treasury Inspector General for Tax Administration George seemed to indicate that the solution is as simple as having the IRS ask foreign financial institutions to provide social security numbers for their accountholders, but I think that comment ignores fundamental flaws and failures in the design of FATCA.

The United States should stop trying to "go it alone" with FATCA, and instead join the OECD standard CRS data exchange framework. This would result in the fair, open and reliable reporting of account information related to all United States residents. FATCA should be repealed, or at least modified to eliminate reporting requirements (both for Foreign Financial Institutions, and also on IRS Form 8938 and FinCEN Form 114 for individual taxpayers) for accounts held by individuals in their country of residence.

It is time for the United States to stop extraterritorial taxation of non-resident citizens. The best solution to this problem is for the US to come into alignment with every other developed nation on the planet and move to a residence-based taxation system for individuals. **The definition of "individual" in Treasury Regulation, 26 Section 1.1–1 should be modified to include only "residents." U.S. citizens who are tax residents of other countries would continue to be liable**

to pay U.S. Federal Income Tax on any income which is effectively connected with the United States, as all non-resident aliens do, by using Form 1040–NR instead of Form 1040.

The tax compliance industry of lawyers and accountants will hate my suggestions because they would remove red tape which drives inordinate amounts of revenue to their industry. But the reality is that by solving these issues for ordinary U.S. citizens who live in other countries, the United States would sacrifice a relatively small amount of tax revenue, while freeing up IRS resources to focus on other larger priorities.

If the United States continues to subject overseas residents to extraterritorial taxation, then it must enhance the capabilities of the IRS to support these taxpayers, and these costs must be incorporated into a cost-benefit analysis of the impact of continuing to force non-resident citizens to report their non-U.S. source income. In a paper entitled, "Mission Impossible: Extraterritorial Taxation and the IRS" published in the Tax Notes Federal journal, authors Laura Snyder, Karen Alpert and John Richardson [2] explain that "international taxpayers" have been identified by the IRS as an underserved community, and that the failure to provide access to the following services, individually and collectively, constitute violations of the Taxpayer Bill of Rights:

- In-person assistance
- Toll-free telephoning
- Knowledgeable IRS agents
- Online accounts
- E-filing
- Timely delivery of postal mail
- Use of other languages
- Explanations of tax obligations
- Making payments to the IRS
- Receiving payments from the IRS
- Third-party assistance
- Low income taxpayer clinic
- IRS internal organization

According to Alpert, et al., these failures when considered as a whole, "manifest a systemic pattern of discriminatory treatment of international taxpayers as compared with domestic taxpayers. The collective failures are evidence that the IRS is either unable or unwilling to administer an extraterritorial tax system."

Finally, let me close by providing some biographical information on myself. I am a United States citizen, registered to vote in the 3rd Congressional District of Pennsylvania. I moved to Japan in 2001 immediately after graduating from college, and have been living and working here ever since. My financial life is entirely in Japan since I've never worked a day in my life in the U.S. and have never earned any money there. I am a tax resident of Japan, and my worldwide income is subject to full taxation under the laws of Japan.

I am employed as a compliance officer for a financial institution, so I have a high attention to detail around my own personal tax compliance matters and try very hard to fulfil the requirements of the U.S. tax system in addition to the tax requirements in my country of residence. The reality, though, is that the U.S. requirements (especially the myriad of required informational filings) get increasingly burdensome every year, and the compliance costs for knowledgeable tax preparers are egregious. I rarely actually owe much tax to the United States, but my annual accounting fees have frequently been higher than the ultimate amount of my U.S. Federal tax liability.

Since my employment income is generated in Japan and denominated in Yen, as are all of my living expenses, I need to organize my financial and retirement planning in Japan. The problem I have is that the U.S. tax laws make it very difficult for me to live the same kind of life that my friends and neighbors live. You see, they are subject only to the Japanese tax system and can organize their finances appropriately. As a U.S. citizen, I am subject to the tax system here in Japan and the U.S. tax system. Those systems are not compatible. Most attempts at responsible financial/retirement planning here in Japan are frustrated by the need to comply with U.S. tax laws. How can this be fair? How can the United States impose

[2] Snyder, Laura, et al.. "Mission Impossible: Extraterritorial Taxation and the IRS," *Tax Notes Federal,* Volume 170, March 22, 2021.

taxation on the non-US income and assets of a person who is a tax resident of another country—often with no economic connection to the United States?

I do not live "offshore." I do live in Japan, where I am responsible for paying tax on my worldwide income at rates of up to 55%. Yet, because I am a U.S. citizen, I am subject to the U.S. extraterritorial tax regime, which means the United States imposes taxation on my non-US income even though I am already fully taxed on that income in the country where I reside, and do not live in the United States. There is no other advanced country in the world that imposes such extraterritorial taxation.

The U.S. extraterritorial tax regime makes it difficult for me to save, invest, participate in pension plans and generally behave in a financially responsible way. This is because all of these essential activities are taking place in my country of residence and not in the United States. My retirement investments are foreign to the United States, but local to me. As a tax resident of both the United States and my country of residence, I get the worst of both tax systems.

This is extremely unjust. For many years, Americans abroad have been attempting to get both Treasury and Congress to address these issues. The time has come for the United States to abandon its extraterritorial tax regime and join the rest of the world in adopting a system of residence-based taxation. I implore you to hold a hearing focusing on the issues faced by ordinary American citizens who reside outside the United States, and to take action on the issues detailed in this submission.

Thank you for your attention to this matter,

James Webster Coates
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Democrats Abroad thanks the Subcommittee on Taxation and IRS Oversight for the invitation to comment on matters covered in their May 11th hearing on "Closing the Tax Gap." This submission reflects our observations on the testimony of the Subcommittee and witnesses, the experience of Americans abroad contending with provisions in the U.S. tax system established to mitigate offshore tax evasion, and our recommendations for strengthening and reducing the unintended adverse consequences of U.S. anti-avoidance policy.

The State Department estimates there are 9 million Americans living outside the United States. Unfortunately, we suffer from the stubborn misperception that Americans abroad are uniformly "high-rollers" living a life of luxury in low- or no-tax countries. This apocryphal stereotype has driven the development of tax policy and regulations, causing inordinate harm to Americans living abroad.

Research published at the behest of Congressional staff demonstrates that we live abroad primarily because a relationship, employment, education, or adventure took us abroad, and we decided to stay.[1] The vast majority of us are middle-class Americans, working, raising families, and retiring in countries with a higher overall tax-burden than the United States. **U.S. tax policies and regulations established to stop tax evasion using offshore bank accounts and tax secrecy jurisdictions do not reflect this reality.**

Measures to foil the efforts of tax evaders and other financial criminals penalize millions of ordinary American citizens in extraordinary ways:

- We are being denied even ordinary banking products and services in the places where we live.
- Relationships with non-U.S. spouses are put under strain because many spouses resent the IRS reaching into their financial lives.

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[1] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.

- U.S. citizens are frequently removed from the joint accounts we share and assets we own with non-U.S. spouse, putting our financial security at grave risk.
- Americans abroad are denied employment, promotions, and business partnerships when roles involve signatory authority over the business accounts in foreign financial institutions.

Given this accounting of the serious personal and financial problems foreign financial account reporting has caused for Americans abroad, Congress can understand why we react with great concern when hearings like this one focusing on the "tax gap" lean towards strengthening international tax-enforcement provisions.

IRS Acting Chief of Research and Analytics Barry Johnson produced data on funds held by U.S. citizens in non-U.S. bank accounts: an astonishing $2.7 trillion, according to 2017 FATCA reports. He also noted that $2 trillion of that is held in tax secrecy jurisdictions [2] where a scant 6% of Americans abroad live (4% of them in Switzerland where eliminating bank secrecy has been an IRS project for a decade.) [3]

The comments made in the hearing by Chairman Whitehouse, Senator Warren, and others made clear that the focus of concern is on high earners, but that provides little comfort to Americans abroad who for a decade have been the minnows caught in the FATCA net meant for big fish.

We have reform recommendations that would, in association with other legislation, help the IRS re-fashion the net to better catch bad actors using offshore accounts to commit financial crimes and hide assessable income. The changes will provide consequential relief for Americans abroad and simplify compliance generally. **And, consistent with President Biden's vision in the American Families Plan, these reforms would help ensure that all Americans have access to essential banking services and the financial infrastructure necessary to live a normal life abroad.**

As the government is building a fairer tax system for all Americans, we propose these updates to the Report of Foreign Bank and Financial Accounts (FBAR):

➢ Indexation to inflation of the FBAR reporting threshold;
➢ Creation of an FBAR filing threshold for Americans abroad that is five (5) times higher than the indexed threshold for domestic filers;
➢ Elimination of duplicate FBAR and FATCA filing;
➢ Modification of the enormously out-of-proportion penalties for non-willful neglect to file FBAR reports;
➢ Provision of an FBAR reporting platform for Spanish and other foreign-language speakers; and
➢ Reinstatement of the option to paper-file the FBAR.

Further, **we re-affirm our support for the Same Country Exception, an exemption for Americans abroad from FATCA reporting of the financial accounts in the country where they live and pay tax.** We believe these financial account reporting reforms fit into the proposed provisions of the American Jobs Plan/Made In America Tax Plan and we want to work with Congress on language to implement them.

AMERICANS ABROAD ARE NOT "FAT CATS"

Democrats Abroad wants desperately to vanquish the persistent stereotype that American civilians living abroad are wealthy "fat cats" avoiding U.S. taxes. The vast majority of us are ordinary working-class Americans, about whom our research has found:[4]

- 61% had household income less than $100,000;
- 72% were married, 71% of whom to non-U.S. spouses;
- 63% owned their own home;
- 32% had moved abroad for marriage or a relationship;
- 25% had left the U.S. for work/employment;
- 64% had made their home abroad and had no plan to return to the U.S.; and
- Most live in countries with a higher overall tax-burden than the U.S.

Americans abroad winced at the joke made toward the end of the "Closing the Tax Gap" hearing that lamented the inability to put a "t" on the end of FATCA to draw

[2] *https://fsi.taxjustice.net/en/faq/what-is-a-secrecy-jurisdiction.*
[3] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.
[4] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.

better attention to the "FATCATS" the law has in its crosshairs. We hope that the Subcommittee members take into account this data and the statistics and comments that follow when they think about FATCA and those Americans abroad who bear its impact.

AMERICANS ABROAD DENIED ACCESS TO EVEN ORDINARY FINANCIAL PRODUCTS AND SERVICES

In implementing FATCA compliance frameworks, some foreign banks and financial institutions have elected to curtail their product offerings to U.S. citizens.

- 36% of Americans abroad have been refused products or services from a foreign bank or financial institution;
- 11% have had accounts in a foreign bank or financial institution closed;
- 10% have been denied a mortgage from a foreign bank or financial institution because of U.S. citizenship; and
- 30% have been denied access to investment or retirement savings vehicles from a foreign bank or financial institution.[5]

Research published in 2014 indicated that one in six Americans abroad has been denied access to financial services because of FATCA. By 2019 that figure had grown to more than one in three. Americans abroad endure on-going difficulty in obtaining even ordinary financial products and services, which gravely impacts their ability to save for the future.

"FATCA has resulted in 6 banks closing my accounts completely or refusing to maintain investment accounts. I had accounts in these banks for 25–40 years." —New Jersey voter living in Germany.

"FATCA has made my life a lot harder. I've been denied the opportunity to open accounts with financial institutions in my country of jurisdiction. I've been evicted as a client from other banks, because they don't want to deal with U.S. compliance."—Washington, DC voter living abroad.

"My banking options were reduced to one, as all other banks contacted would not accept U.S. citizens. Many investment options are also not available due to U.S. citizenship. Not allowed to invest here or in the U.S.A."—Montana voter living in Austria.[6]

"I was shocked by the closure of two of my local bank accounts, especially as the large bank in question (Deutsche Bank) did not even explain correctly why it had to close those accounts—they basically made up nonsensical reasons (unfounded under the law) and clearly got FATCA wrong."—Washington, DC voter living in Belgium.

"I don't blame German banks for denying me certain services because of FATCA—at the same time, most American banks deny me services because I do not reside in the U.S. Stuck between a rock and a hard place, it feels like my own country is punishing me for living abroad."—California voter living in Germany.[7]

'My bank of 17 years, Barclays, will only allow me to have checking accounts and savings accounts that pay simple interest (.01%). I am subject to onerous paperwork. I am being treated like a criminal and I have never done anything wrong." —New York voter living in the United Kingdom.[8]

"I am unable to access the majority of "normal" investment products for basic college or retirement savings in either the UK or the U.S. due to my U.S. citizenship. This will have an even greater impact on my children, who will be unable to live normal lives from a tax/savings point of view as dual US/UK citizens living abroad."—Maryland voter living in the United Kingdom.[9]

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[5] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.

[6] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.

[7] "Stories of FATCA: Affecting Everyday Americans Every Day," October 2014, Bit.ly/FATCAStories2014.

[8] "Stories of FATCA: Affecting Everyday Americans Every Day," October 2014, Bit.ly/FATCAStories2014.

[9] "Can We Please Stop Paying Twice? Reforming the Tax Code for Americans Abroad," October 2017, Bit.ly/CanWePleaseStopPayingTwice.

AMERICANS ABROAD SUFFER RELATIONSHIP STRESS WITH NON-U.S. SPOUSES

Research published in 2019 found that nearly one in five Americans abroad had been removed from a joint financial account held with a domestic spouse/partner, up from one in eight in 2014.[10]

- 19% have been removed from an account with their non-U.S. spouse/partner;
- 4% report that their non-U.S. spouse/partner would like to divorce/separate due to U.S. foreign financial account disclosure requirements;
- 9% have been denied an account in a foreign financial institution for a U.S. citizen child;
- 5% have been denied trustee or power of attorney abroad; and
- 7% have been denied or lost position in a non-commercial organization requiring foreign bank-signature authority.[11]

The strain FATCA has placed on the relationships of Americans abroad with their non-U.S. partners is certainly underreported as well. Individuals denied joint ownership of financial accounts and other assets sacrifice consequential financial support and control. They become dependent on their non-U.S. spouses, which brings financial and even physical risk.

"My husband refuses to share a main savings account with me now, which puts me at a disadvantage in the event that something should happen to me, as I would have no legal access to that account. It has put great stress on my marriage."—Iowa voter living in Germany.

"I fear that because of FATCA I will lose all means of independent access to funds and, if something happens to my husband, I won't be able to access our household accounts because my name is not included on the accounts. FATCA is driving us to keep large amounts of money at home, which is not a safe option in most countries."—American voter living in Vietnam.

"My non-U.S. husband does not understand how it can be possible that I am obliged to send his personal financial information to a foreign government. Therefore, we have taken my name off our accounts. After 30 years of marriage, I no longer have free access to our money. I am not surewhat situation I would be in if he were to pass away suddenly."—American voter living in Italy.[12]

"The FATCA, FBAR, and PFIC requirements are having a material negative impact on me and my family and are just so unfair. I can understand why the U.S. wants to suppress tax avoidance, but the legislative framework has delivered a blunt instrument that treats the wealthiest and poorest alike as far as reporting requirements are concerned. The results are absurd, costly, and unimaginably stressful." —California voter living in New Zealand.[13]

AMERICANS ABROAD ARE DENIED OPPORTUNITIES

Americans whose role or position depends upon them having signature authority over foreign bank accounts will have FATCA reporting issues *even if they are not the beneficiary of the account* nor a shareholder in the business.

- 3% of Americans abroad have been denied employment positions requiring signature authority on business accounts in a foreign bank;
- 7% have been refused participation in business and partnership opportunities; and
- 4% have been asked by their employer to surrender signature authority over business accounts in a foreign bank.[14]

Americans abroad report being deemed ineligible for these roles, are unable to advance in their profession or to start their own business.

[10] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad *and* "Stories of FATCA: Affecting Everyday Americans Every Day," October 2014, Bit.ly/FATCAResearch2014.
[11] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.
[12] "Stories of FATCA: Affecting Everyday Americans Every Day," October 2014, Bit.ly/FATCAStories2014.
[13] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.
[14] "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation," Bit.ly/FilingFromAbroad.

“I (was) told due to reporting/signing requirements a U.S. citizen could not be offered the Job.”—Delaware voter living in Austria.

“I was told they did not want an ‘American person.’ Too costly, complicated, and dangerous, they said.”—American living abroad.[15]

“The legislation was cited by the prospective employer who indicated that they would only engage me if I accepted cash payments. I figured this was a sure fire way to get arrested and dragged into an expensive legal proceeding that would only result in my paying out even more money, so I declined the position at the local university.”—American living in Thailand.

“Americans abroad should be huge advocates for America and American businesses. Instead, the U.S. government makes it difficult to save for retirement, puts on onerous reporting requirements that mean that most foreign (and in some cases U.S.) entities won’t hire you if signature authority is required. I know of at least one large U.S. tech firm that has simply stopped hiring Americans abroad—too difficult and expensive for the company and the employee. I’m watching two friends try to figure out how to comply with the GILTI tax without completely destroying their small business. How is any of that good for American business or employment of Americans?”—Texas voter living in Australia.[16]

MAKING THE CASE FOR REFORMS TO FBAR AND FATCA

Court cases involving FBAR violations are not rare. The foreign financial account reporting requirement is clearly instrumental in the apprehension of tax evaders using offshore financial accounts to hide assessable income. The perpetrators, however, are invariably citizens living inside the U.S. rather than abroad.[17]

Rules guiding the implementation of FBAR have not been adjusted since the law was passed in 1970. Reasonable updates can both improve the report’s focus on bad actors and simplify compliance for Americans abroad.

PROPOSAL: We propose the following reforms to the FBAR

1. Index the $10,000 reporting threshold for inflation;
2. Create a separate reporting threshold for Americans living abroad, perhaps 5 times higher;
3. Address the duplication of reporting on FBAR and FATCA, as recommended by the IRS National Taxpayer Advocate;
4. Modify the out-of-proportion penalties for non-willful failure to disclose accounts;
5. Restore the option to submit FBAR paper filings; and
6. Provide for FBAR reporting in Spanish and other languages.

Further, we re-affirm our long-standing support for the Overseas Americans Financial Access Act which would exempt from FATCA reporting the foreign financial accounts of Americans abroad in the countries where they live and face taxation because tax cheats do not hide assessable income in the countries where they live. Further, the Corporate Transparency Act adds a powerful new tool for discouraging and apprehending tax cheats. As the law mandating disclosure of beneficial interests in anonymous shell companies is implemented, reports will illuminate the activities of the tax cheats and other bad actors that foreign financial account disclosure did not.

Consistent with President Biden’s vision in the American Families Plan, these reforms would help ensure that all Americans have access to essential banking services and the financial infrastructure necessary live a normal life abroad. They can be modified to exempt certain individuals from eligibility and ensure they enhance existing tax-enforcement mechanisms. They will focus policy on bad actors, and provide relief to those who have long suffered unintended adverse consequences, such as bank lock-outs. Finally, these FBAR and FATCA reform recommendations are entirely consistent with the goal of getting everyone to pay their fair share.

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[15] “Stories of FATCA: Affecting Everyday Americans Every Day” October 2014, Bit.ly/FATCAStories2014.

[16] “Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation,” Bit.ly/FilingFromAbroad.

[17] *https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/workingpaper/52199-wp-taxcompliance.pdf.*

CONCLUSION

Democrats Abroad understands that non-resident Americans are bystanders in an on-going war against tax cheats and other malign actors who abuse foreign financial accounts, anonymous shell companies, and tax-secrecy jurisdictions. We know that those seeking to hide assessable income from the IRS, or crimes from law enforcement, engage legions of clever lawyers, bankers, accountants, and formation agents to collaborate on the development of ever-more-complex illicit schemes.

But Americans abroad also need government officials to understand our experience of anti-abuse laws, so that they can strike a better balance in policy-making between, on the one hand, discouraging and apprehending financial criminals—which we strongly support—and, on the other hand, caring for the welfare of ordinary Americans living abroad.

In this submission we have demonstrated how the household accounts, retirement savings, family harmony and personal security of Americans abroad have been gravely impacted by FATCA. As we noted in the title of a research report we published in 2014, FATCA affects everyday Americans every day.[18] Can you imagine the reaction of Americans abroad when they heard Treasury Inspector General for Tax Administration J. Russell George testify that **the IRS has STILL "taken virtually no compliance action to meaningfully enforce FATCA"?**[19]

Ordinary law-abiding Americans abroad, the unintended objects of FATCA, have suffered an extraordinary amount of personal and financial disruption, anxiety and duress, and yet, after ten years, the IRS has still not begun to use FATCA reports to identify and apprehend genuine lawbreakers. This is a disturbing injustice, and we strongly urge the Subcommittee to review our research, the testimonials of your constituents abroad, and the abundant scholarly material indicating the ways that Congress can provide relief to law-abiding Americans abroad.

Former National Taxpayer Advocate Nina Olsen made this comment during the hearing: "The IRS needs transformational change, change that must occur in the context of minimizing undue taxpayer burden and protecting taxpayer rights."[20]

We agree. We support enhanced funding for the IRS, which we ask to include funding to address the serious deficiencies in IRS service and support to Americans abroad trying to comply with their filing and reporting responsibilities.

For many years the IRS has provided little to no advice about tax-filing obligations to non-resident citizens. Ignorance, misinformation, and confusion abound, even among consulate and embassy staff. In recent years, the IRS has withdrawn staff from international postings and replaced them with telephone and online support that vastly underestimates how inordinately difficult it is to file taxes from abroad. FreeFile programs are not suited to non-resident filers, and free support from volunteer tax-return preparers available to aged and indigent taxpayers in the U.S. is not accessible to those living abroad. These are all matters that should be addressed with the new IRS funding proposed by President Biden.

Thank you for the opportunity to comment and provide recommendations. Not since the Carter Administration has there been a hearing in the U.S. Congress on Americans living abroad and the range of serious personal and financial problems U.S. taxation causes for them, their families, their businesses, and the U.S. and non-U.S. entities with which they do business. **We re-state our belief that it is past time that the issues of Americans abroad be heard, documented in the public record, and addressed by the government.**

Thank you for your interest in these matters. Please contact Carmelan Polce of our Taxation Task Force (+61 404 767 088 or carmelan@democratsabroad.org) or the undersigned with any questions about the information and recommendations provided herein.

Sincerely,

[18] "FATCA: Affecting Everyday Americans Every Day," October 2014, bit.ly/FATCAResearch2014.

[19] The IRS, after doing an enormous amount of work with countries around the world to get FATCA off the ground, still lacks the ability to match up the information it receives from banks with the information it receives from taxpayers; *https://www.finance.senate.gov/hearings/closing-the-tax-gap-lost-revenue-from-noncompliance-and-the-role-of-offshore-tax-evasion.*

[20] *https://www.finance.senate.gov/hearings/closing-the-tax-gap-lost-revenue-from-noncompliance-and-the-role-of-offshore-tax-evasion.*

Candice Kerestan
International Chair

LETTER SUBMITTED BY DARCEY GILLIE

I am the child of a manual worker and a store cashier, leaving America over 20 years ago to study in the UK. I fell in love, married and have made my home here ever since with my spouse. My career here in the UK been devoted to helping people as a university teacher, secondary school teacher, and as a guidance counsellor; I volunteer in conservation and social care. I am living the American dream made available to me through Pell Grants and Sallie Mae loans. Before I even knew about my IRS compliance obligations, I paid off (in fact, I believe I over paid by 17 dollars) the student loans I incurred to pay for my UK studies. As soon as I discovered my tax compliance obligations (no one tells you), I immediately (at eyewatering expense for a guidance counseller) engaged a tax professional to help me through the streamlined filing process to "get compliant."

The Americans I know of abroad are university workers, hospice administrators, stay at home moms, English teachers, law enforcement officers, and health care professionals. We are not the super wealthy. We may be comfortable, we may be struggling—we all need to think about the next paycheck and what the future holds. We are also the people most likely to follow the rules. The super rich have the money, connections, time and resources to continue to avoid tax compliance. I don't even have the time or energy to iron my clothes or make dinner beyond a sandwich some days.

I am a dual national living in my country of second citizenship, with my spouse. It doesn't make me less American or somehow a "bad" American, which is how laws like FATCA and the ways in which American emigrants are talked about make me feel. I have never met an American or anyone else who, upon my explanation of the tax situation of Americans abroad who say it's a good thing. All of the m are appalled and immediately see the unfairness of it. Many non-Americans ask my why I don't renounce. Frankly, I'd rather cut my right arm off. I was born and American, and I shall leave this earthly world an American. Being American is the source of the characteristics and attributes people value in me the most. In my over 20 years living in the UK, I have been ambassador for American ideals and values.

In the United States we are nurtured to believe ourselves part of a tradition of justice, equality, opportunity, fairness—and as such a beacon to the world in all these things and more. Our foundations as a nation rest on the humane and compassionate ideals of the American Enlightenment:

> We hold these truths to be self-evident, that all men are created equal, that they are endowed, by their Creator, with certain *unalienable Rights,* that among these are *Life, Liberty, and the pursuit of Happiness.*

Laws are conceived and established by governments to promote the security, prosperity, and well-being of a nation and its people. In the United States of America, since 1776 we—the people and our Government—have agreed that citizenry are endowed with the unalienable rights of Life, Liberty, and the Pursuit of Happiness.

It is with great regret, then, that I find myself writing this letter because the United States of America, through FATCA and its citizenship-based taxation regime, has abandoned me, betrayed my trust and loyalty, and denied my me unalienable rights to Life, Liberty, and the Pursuit of Happiness.

The United States of America was founded by men and women who could no longer tolerate the oppression and overreach of a British government hungry for revenue. Punitive taxes prohibited healthy business, innovation, growth—and for many people, simple survival. Despite the lessons taught to us by the founding of our own nation, it is strange to find ourselves here in 2021, where American citizens abroad—making new lives for themselves, on distant shores, are being subject to the same intolerable intrusions, demands, and punishments as our ancestors.

Many submissions to this hearing will make highly technical legal arguments. And I am grateful to the knowledge and expertise of the men and women who can do this. I am a university guidance counsellor. I make no pretense to understanding the most complex tax code in the world. My representation for myself and the estimated 9 millions Americans abroad is historical, moral, and ethical—and deeply personal. Laws should never be conceived that—intentionally or otherwise—harm individuals' fundamental rights. FATCA and the tax code that applies to Americans residing abroads harms us in diverse ways, depending on circumstances and where we live. There is even no equity within an already unequitable situation.

Sadly, because we are diaspora, because there are no votes to be garnered from supporting us; because of a persistent erroneous belief we are all "GILTI" "FATCATs" with Swiss bank accounts—no one in the United States Government cares about us and no one is moved to help alleviate the deliberate harm being caused to us. We are the collateral damage of well intended but poorly conceived legislation. Laws must work for all citizens or they work for none. FATCA sets a terrible precedent for the rights of every United States citizen—paving the way for intolerable intrusions into privacy and oppressive monitoring not subject to normal legal safeguards such as probably cause and warrants. Our founding fathers would be appalled at the road the United States Government taken with FATCA, and citizenship-based taxation.

Representative Neal once said that he did "not accept" that FATCA is a "burden". I am sure if Representative Neal found himself considered a criminal by virtue of having a "foreign" bank account he would only find it a burden, he would find it an intolerable injustice:

1. Reporting to FinCEN is an enormous psychological burden. In no other situation are American citizens presumed to be guilty by virtue of certain characteristics (*i.e.,* a "foreign" bank account). This is an utter betrayal of U.S. citizens by the U.S. Government. It causes me weeks of psychological stress and anxiety every year.

Query: How would you feel if you were considered a criminal by virtue of where you lived, and on no other basis?

2. I have been refused accounts by banks, prohibited from investing in local green energy schemes, and discouraged from board membership of charities.
3. It is a time burden to check my accounts—up to 8 hours to check and recheck the data, plus enter it into the FinCEN site.
4. I choose to do my own FBARS because my affairs are fairly simple—for others it can add hundreds or thousands in compliances costs to engage a tax professional to do this. I accept the near constant stress and worry about excessive fines for mistakes because I can't afford to add to what I already pay my accountant to ensure my IRS compliance.
5. My bank account is NOT foreign or abroad. I do not live "off-shore." I reside permanently in the UK. It is my local bank. I generally spend a maximum of 21 days a year in the U.S.
6. Being happily married, I share a bank account with my UK spouse. FATCA means that his data—that of a citizen completely foreign to the US, who has never lived or worked there—is being shared with a foreign government and he is subject to the laws of a foreign country.

Query: Would any of you be happy putting your most sensitive information in the hands of a foreign government, as my spouse is forced to?

7. Others I am sure will provide more detailed on nuanced discussion of data protection. Suffice to say, given the recent Treasury data breach, I do not feel satisfied that my most sensitive financial data is currently in good hands via FATCA.

Queries: Can you absolutely 100% guarantee the safety of my personal data? What compensation or support will I receive if I become a victim of a data breach caused by FATCA?

8. FATCA has prevented me from setting up a small charitable foundation with my spouse to support first generation university students (like I was) with small grants (£100–200) towards their university education. I don't have the time, money, energy or know-how to tackle compliance with U.S. laws. It distresses me that I am prevented from paying forward the same support to young people in small scholarships that helped me at that age.

In every way, FATCA undermines and denies hard working Americans (who happen to live abroad) their rights to life, liberty, and the pursuit of happiness. I have been deeply affected by the stories of Tina, the Canadian woman (but also "U.S. Person") who late in life discovered her obligations as an accidental American. Can we all stop to imagine and empathise for a moment how the realisation of compliance and its costs must have felt? Can you feel thee tight knot of fear she felt when realising that FATCA would cost Tina her modest savings and support for retirement? How can members of Congress be happy and content with this sort of suffering? Let's remember in this Easter season: "What you do to the least of my people, you do to me."

The story of Ronald Aries has also touched me. Can you imagine working hard, as a highly trained professional on whom the safety and lives of others depends, get to a well-deserved retirement and find yourself on the precipice of losing everything? Read this—and imagine yourself as Ronald Aries. You get a letter from your bank closing your account, refusing your mortgage on the house you were buying for your old age, plus 10s, if not 100s of thousands of dollars in compliance costs and fines. What is happening to Ronald Aries is not moral, it is not just. In every way it abandons the humane ideals of the American nation.

I am delighted to pay taxes. In the UK, we have a fairly simple, straightforward system and I barely have to think about it. On the rare occasion in the past 20 years when there has been an error—mine or HMRC's—I ring them up, we settle the matter—there are no punishments or penalties for making a mistake. I either increase my monthly contributions or decrease depending where the error lies. My taxes ensure that children are educated, we have law enforcement, fire services, clean streets, disability support, a safety net for those who have lost their jobs, good roads, universal health care free at the point of delivery, and so much more. Every year, all UK citizens receive a statement informing them of how their tax money is spent.

No one disagrees with the intention of American lawmakers to hold large companies or resident Americans "off-shoring" vast wealth accountable for tax contributions. The U.S. Government might find it more effective to start at the other end of the process—changing hearts and minds about taxes—making them something people want to contribute to rather than avoid. As a constructive suggestion in all of this, what about periodic (3–4 times a year) televised updates of how federal tax dollars are being spent nationally and locally to support and improve people's lives? Inspire people instead of alienating and frightening them. Make tax avoidance as socially unacceptable as smoking in a restaurant or drink driving.

If the United States Government wants to create a fairer society, it needs to start by setting the example. FATCA is a law of anger, vengeance, fear, and punishment. It is a microcosm of the whole legislative philosophy of the United States Government at the moment. Bring back inspiration, aspiration, hope, compassion, and our unalienable rights to the process—and America will flourish.

As second constructive suggestion, I urge the United States Government to explore (and implement) progressive forms of taxation that enable some of the ambitious changes we need and have proposed for society: *e.g.,* sugar taxes, fossil fuel taxes, higher sales taxes, land taxes, etc. Here in the UK, besides paying some of the highest income tax in the world, I pay 20% valued added (sales) tax on almost all goods and services, car tax (higher for more polluting vehicles), and also pay council tax to cover local infrastructure, social, welfare investment and other services.

All countries in the world (excepting Eritirea, of course) demonstrate that it is possible to fund their governments (some such as Denmark, the Netherlands and Sweden, quite generously) without harassing their overseas private citizens. Other nations who have tried citizenship-based taxation (*e.g.,* Mexico, Romania) gave it up, or limit it to a few years after someone emigrates.

Queries: Why is the United States of America different? Why do you have to be so unjust to us? Why do you hate us? We are a tremendous source of free soft power all over the world. Instead of cultivating and supporting us, you punish us—over and over.

There isn't even equity in your punishment of us—it depends entirely on the nature of the tax treaty the United States has with the country we live in—if indeed there is one. I am aware that I enjoy the advantages of the tax treaty between the U.S. and the UK, whilst my fellow citizens living in Mozambique, Jordan, Singapore or Afghanistan do not. People are prevented from saving adequately for their retirement due to laws around PFIC (which I don't understand, and so avoid anything other than a standard savings account in a bank), and are subject to double and even triple taxation—no doubt putting higher social care burdens on the country where they live. Women are already at a disadvantage globally in terms of retirement income. FATCA and citizenship based taxation reinforces and deepens this disadvantage.

Query: As a middle aged, middle income woman—how would you, under current laws, recommend that I save adequately, responsibly, and without penalty for my retirement in the UK?

Whilst I can understand that updating the tax code to reflect the 21st century needs and interests of American citizens abroad will be time consuming, "Simple Regulatory Fix for Citizenship Taxation" (Richardson, Snyder, and Alpert (2020), 169 *Tax Notes Federal* 275, available at SSRN: *https://ssrn.com/abstract=3725506*), easily and fairly solves problems for everyone. It will enable the IRS to refocus efforts on tax avoiders, rather than spending time and money on America citizens who are tax resident (and compliant) in their country of residence.

I am over halfway through my life, if I can trust the actuarial tables. Things I should be worrying about:

- My mother's (who lives 3,000 miles away) advancing dementia.
- Her recent stroke.
- Her recovery from bowel cancer.
- The fact that she cares for my 101 year-old grandmother—who lives 6 hours from my parents.
- My sister who is caring for my mother, my 80 year-old father, and (in reality) my 101 year-old grandmother.
- My preventive chemotherapy for breast cancer and maintaining good health.
- As a childless woman, making adequate preparations for my own old age.

Things I should not be worrying about:

- Complying with burdensome, amoral, intrusive laws that have no positive benefits for society or individuals.
- The excessive penalties should I make a mistake.

Thank you for taking the time to organise this hearing, to read and listen to all of the evidence, including mine. I hope that on hearing our stories, engaging with our suggestions, and on the balance of evidence you will be able to work with us to find a solution the restores our rights and freedoms as American citizens. At the very least, please find it in your heart to have a little mercy on us—and recognise we are not the source of the Tax Gap.

Yours sincerely,

Darcey Gillie

LETTER SUBMITTED BY DONNA HARTFORD

Greetings to members of the U.S. Senate Subcommittee on Finance,

I am writing in support of the recommendations by the Democrats Abroad Taxation Task Force, regarding the April 26 hearing on funding the American Jobs Plan and the American Family Plan, and the Subcommittee on Taxation and IRS Oversight, May 11, 2021. Specifically, the committee proposes reforms to "ease the tax and tax filing burden placed on Americans living abroad." This submission from May 7, 2021 is accurate in identifying Americans like myself living abroad:

> The vast majority of us are middle-class Americans, working, raising families, and retiring in countries with a higher overall tax-burden than the U.S.—Creating Opportunity Through a Fairer Tax System—Comments and Recommendations in Support of Americans Abroad

I was working as a social worker in Chicago over 25 years ago, when a chance meeting with a Canadian on a business trip changed my life. I have lived in the Vancouver, BC area since we married, 2 years after meeting. I first became a Permanent Resident and a step-mom, later a grandmother and Dual Citizen of Canada and the U.S.

I have worked for my husband's office supply company for over 20 years. He had started working for others, then slowly built his own small business from scratch. We enjoy a comfortable life, but not one of luxury. We were able to buy a modest home in a quiet village 15 years ago, my first time as a homeowner. Our grown daughter and her fiance' live with us. My step-children work in the family business and we employ several other people as well: people who depend on their jobs to support their families. However, without reform of current U.S. tax policies, our home, our business, our retirement and financial security (especially mine, individually), will be in jeopardy.

We file Canadian and U.S. taxes as well as FBAR requirements through our accountant. We file on time and pay any taxes owing on time. It costs me approximately $400–$500 a year for the accountant to prepare my tax return and FBAR. My income is below $40,000 U.S., and our joint income is less than $100,000 U.S. I do not own shares in the family business. As we approach retirement most of our income will come from modest retirement savings in registered retirement accounts that we have worked hard to save over the years, and the equity in our home.

When we bought our home 15 years ago we could have put it in my husband's name only. The down payment came from the house he owed that we sold to buy this one. We felt that as a couple who live together, raise a family together, and run a small business together owing a home together would be the right thing to do for our relationship. When we purchased the home, prices were expensive in Vancouver, compared to other cities, but it was under $500,000. We were not aware at the time that I would be responsible for capital gains on the sale of the home in the future. We have renovated the home to make it comfortable for us and my step daughter and fiance but it is still a modest home. As prices have risen in our area I am now in a position where I may have to pay capital gains on my portion of the home when we sell to support our retirement. As mortgage interest is not deductible in Canada, I am not able to deduct this amount, yet may have to pay a capital gains tax that is not charged on principal residences in Canada. This has caused my husband and I a huge amount of anxiety and put some strain on our relationship. I understand if the current policies are not amended or abolished, the I.R.S. would expect us to pay taxes in excess of $40,000 on the sale of our home as it is currently valued. Not only is this unfair, but impossible, which means ineffective.

We are people who file our taxes, pay our taxes, employ others, do not hide any assets that we have and contribute to our community. **The U.S. is the only country in the world that does not follow a resident based tax system.** I feel as though I am being punished for being a U.S. citizen living in a foreign country. Canada is The United States closest Neighbor, ally, and friend; the two counties have tax and trade treaties that cover many issues. It seems to me that treating average middle class citizens fairly should be at the top of the priority list not the bottom simply because we don't have a powerful lobby group or much political clout.

I voted for President Biden, knowing the unfair tax-filing and invasion of privacy for Americans living abroad would remain until Congress heard from enough average citizens who will be deeply hurt if these policies are not abolished or revised. The so-called wealthy, tax-avoiding "fat cats" are a separate entity from working people like myself, and we should be treated accordingly.

I urge President Biden, and congress to remove the fear and uncertainty that many of us living abroad are feeling. I have been and am a loyal U.S. citizen. The United States was founded on the values of equality for all and no taxation without representation. Our international reputation has also been built on these values.

As a U.S. citizen living abroad, I feel as though the tax system is punishing me rather than treating me as an equal.

Please do the right thing and amend this unjust law.

Respectfully submitted,

Donna Hartford

INDEPENDENT COMMUNITY BANKERS OF AMERICA
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The Independent Community Bankers of America, representing community banks across the nation with nearly 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing titled: "Closing the Tax Gap: Lost Revenue from Noncompliance and the Role of Offshore Tax Evasion."

ICBA is supportive of effective and balanced measures to increase revenue through improved compliance, including increased funding for targeted IRS audits. However, we strongly oppose the Administration's proposal to require increased bank reporting because of the costly, error-prone burden it would place on community banks in exchange for a highly uncertain benefit. We urge Congress to pursue other means of improving tax compliance.

Community Banks Already Responsible for Significant Reporting on Accounts and Transactions to the IRS and to Treasury

While full details are not yet available, the Administration's American Families Plan includes a proposal that would require financial institutions to report information on financial account flows. The White House believes that this and other compliance proposals would increase tax revenues by $800 billion over a period of 10 years.

ICBA strongly objects to this proposal for the following reasons:

- It would create a costly and complex new reporting burden for community banks that already carry significant data collection and reporting obligations for the federal government, effectively acting as uncompensated agents of the government. These obligations include reporting to the IRS through the furnishing of Forms 1099 and 1098 to support tax compliance. More significantly, banks are subject to extremely burdensome reporting under the Bank Secrecy Act to detect tax evasion, money laundering, and expose shell companies used for terrorist financing and other crimes. Specifically, banks must file a currency transaction report (CTR) for every deposit or withdrawal of more than $10,000, a threshold that has not increased since the 1970s, as well as suspicious activity reports (SARs). Banks dedicate significant resources to BSA reporting and report millions of transactions to the Financial Crimes Enforcement Network (FinCEN). More recently, banks are required to collect and report beneficial ownership information on commercial accounts under the new customer due diligence rule. The government increasingly turns to the banking system to act as police for a variety of criminal, or fully legal but controversial, conduct. Burdening community banks comes at a cost: It diverts resources and management from their core function of providing credit and other banking services to individuals, families, small businesses, and other entities that make up communities.
- The Administration proposal would expose banks penalties for inadvertent errors. The IRS will try to reconcile millions of pieces of information reported by banks with information provided by individuals. Mismatches will trigger audits. But there are numerous sources of mismatched information. Accounts are opened and closed throughout the year, and account ownership changes as couples marry and divorce and individuals are added and removed from accounts. These factors will reduce the value of the reported information, create mismatches, and trigger audits. Banks should not be placed in the middle of inevitable disputes between taxpayers and the IRS. Banks may be forced to freeze accounts or garnish income as disputes are addressed.
- The proposal would channel more personal taxpayer information into the IRS than the agency can realistically track and process. It is unreasonable to require banks to provide information at significant cost that cannot be effectively used.
- Estimates of the tax gap vary widely. There are serious grounds for skepticism of the Administration's claim that increased tax enforcement would raise tax collections by $700 billion. An analysis by the Congressional Budget Office found a much lower figure of $103 billion. There is simply too much uncertainty to justify the creation of a significant new burden for community banks.
- Reporting to the level of granularity proposed by the Administration would infringe on account holders' privacy. Much of the data collected on cash flows would be irrelevant to an account holder's tax liability. The Administration's proposal would be the equivalent of sending all account holder's bank statements to the IRS.

ICBA supports the Administration's proposal to increase the IRS's audit resources. Better trained auditors with more sophisticated technology at their disposal may well significantly increase tax collections without costly, burdensome, and intrusive new bank reporting requirements.

Closing

Thank you for convening today's hearing. Closing the tax gap can and should be an alternative to raising taxes on American individuals, families, and businesses. However, we ask you to reject enhanced bank reporting of customers' personal financial statements and information that are unrelated to their income tax returns. This is a risky and counterproductive proposal that would yield uncertain benefits at significant cost to institutions that are best focused on serving their communities' credit needs.

LETTER SUBMITTED BY NICHOLAS MATTHEW LEE

U.S. Senate
Committee on Finance

Dear Senators,

Thank you for the opportunity to submit comments regarding the May 11th hearing on "Closing the Tax Gap"—funding necessary spending on infrastructure through making the wealthy pay their fair share is a laudable goal.

Unfortunately, I must express my deep concern that once again, the discourse in the Senate Finance Committee is one based on prejudices, assumptions, stereotypes, and a willful refusal to consider the realities of the policies that they are discussing.

The Senate Finance Committee has been repeatedly informed in filings from a number of groups that have commissioned their own research into the demography of non-resident U.S. citizens, and they are unanimous in their findings—we are not rich. We are not fat cats. When examining gross incomes, we are overwhelmingly average. When looking at net incomes, we are *average to below average.*

The statement by Senator Whitehouse about renaming FATCA to FATCA(T) is not just inappropriate—it's wrong. It ignores the realities of the harm that FATCA has inflicted on 9 million Americans that live overseas, and it ignores the reality that the harm is disproportionately inflicted on the working and middle class.

In this statement, I will outline my response to the hearing and its relation to the Treasury's recently announced "American Families Plan Tax Compliance Agenda." Much of this will rely on observations relating to the implementation of the Foreign Accounts Tax Compliance Act (FATCA), which has been a remarkable failure with respect to its inability to raise revenue, its lack of effectiveness in preventing the wealthy from avoiding taxes, and the collateral damage that it has inflicted on the middle class.

U.S. Taxation of Individuals and the Extraterritorial Nature of FATCA

To understand the harms of FATCA, it is first necessary to understand what makes it such a uniquely problematic piece of legislation.

In short, the United States is the only developed country in the world that asserts a global right of taxation over non-residents in addition to its residents. Fundamentally, this underlies a view that the United States may freely impose its laws, regulations, and taxes in any foreign country, in violation of their own sovereignty.

This mentality is reflected in the FATCA legislation. The U.S. establishes a definition of persons subject to special reporting definitions, they assert a right to impose on foreign institutions a penalty so draconian that it is viewed as a "corporate death sentence", and under threat of this penalty, they coerce foreign governments into signing Inter-Governmental Agreements (IGAs).

Problems With Banking Access

Because of the risk of sanctions from the U.S. and the unique reporting requirements that greatly differ from the global Common Reporting Standard (CRS), many Financial Institutions simply refuse to do business with U.S. Citizens seeking accounts in the same country they live in—we are neither worth the cost, nor the risk.

The data regarding access issues is well-documented by research and Statements for the Record submitted over the past 10 years by:

- American Citizens Abroad
- Association of Americans Resident Overseas
- Democrats Abroad
- Republicans Overseas
- SEAT: Stop Extraterritorial American Taxation

The impacts of FATCA on U.S. citizens vary significantly between countries and jurisdictions, but ultimately, between ⅓ and ½ of overseas Americans have been denied access to simple bank accounts. When considering retirement accounts, investment accounts, or mortgages, the proportion increases.

Worth noting as well, Americans often have difficulty obtaining access to accounts that are actually exempted from institutional requirements under the FATCA IGAs.

I personally have been denied a Dutch retirement account *(Dutch Art. 3.126a Wet Inkomstenbelasting 2001)* that is exempted from institutional reporting. The account administrator noted that while the account is exempt from reporting, the are concerned that the account could become reportable if the IGA is amended, and that their risk and compliance department cannot justify the cost and risk of permitting U.S. Citizens resident in the Netherlands and complying with FATCA. They simply refuse us as customers instead.

FATCA Harms the Working and Middle Class, not the Wealthy

It is important to understand that these reporting requirements disproportionately harm the working and middle class—the wealthy have lawyers, tax consultants, and can meet the "High Net Worth Client" tests that exempt them from the ever-present "No Americans" rule that many foreign financial institutions now have.

Indeed, especially when we move beyond simple bank accounts towards investment accounts and retirement accounts, those are *essential* to the middle class. In the country I live in, bank accounts have negative interest rates, and it is *assumed* that any appreciable sum of money will be invested. Similarly, you are expected to make the maximum legally permissible retirement contributions—our 50% income tax rate all but requires it.

By failing to respond to financial access issues raised going back as early as 2014, and especially in a 2017 House Oversight hearing, Congress perpetuates a harm that disproportionately affects the middle class.

A billionaire does not need a retirement account whose contributions are capped around $5,500 per year. That is pocket change to them, and they would never evade taxes in such a regulated and monitored account. A working or middle class resident most definitely needs this if they are to have any hope of something more than a subsistence retirement.

FATCA Harms Law-Abiding Americans, not Tax Cheats

FATCA's draconian penalties for institutions relate to tolerating customers that are non-compliant on their U.S. tax obligations. Unfortunately, it's never been clearly defined for institutions what constitutes a violation, and what qualifies as due diligence.

A common argument from banks here for rejecting U.S. citizens for accounts is that while we can prove our tax compliance *now,* they are concerned that we will open accounts as a tax-compliant Americans and later go delinquent—and they'll be the ones stuck with the biggest fines.

Without adequate safe-harbor provisions and a delegation of enforcement to local courts, it is unlikely that this behavior will change.

Discrimination is simply the most effective form of risk management.

Congress Has Failed to Protect U.S. Citizens While Implementing FATCA

In numerous venues dating all the way back to FATCA's original introduction, the concerns by Non-Resident U.S. Citizens, banks, foreign governments, and advocacy groups have been disregarded.

While there could have been safe-harbor language included, or even language requiring non-discrimination under threat of penalties equal to enabling tax evasion, none of this has been added.

In congressional discussions, the issues are often brushed away with "we need more research" or "we need more official research."

It is 2021, and there is a wealth of data and research available. None of this is Congressional research, but this is because Congress has stubbornly and obstinately refused to discuss the issue or to commission research.

The Commission on Americans Living Abroad Act of 2019 (H.R. 4363) would have conducted such research, but there has been no desire to advance it or similar legislation beyond committee—perhaps out of fear that it might force the House and Senate to confront uncomfortable truths about the corrosive effect of FATCA on U.S. citizenship.

The corrosive effect is evident in the number of U.S. citizenship renunciations published in the federal register. Since the enactment of FATCA, there has been a steady and accelerating increase in the number of Americans forced to renounce citizenship—not for tax reasons, but because of pervasive discrimination against Americans.

While Relentlessly Pursuing Delinquency on U.S. Taxes, the U.S. Enables Foreign Tax Cheats

Interestingly, while the United States demands total cooperation in enforcement from other countries, it has thus far failed to provide any meaningful assistance in preventing offshore tax evasion by non-U.S.-Persons seeking to hide their wealth in U.S. banks.

Indeed, the FATCA IGAs are either non-reciprocal, or the reciprocal provisions have never been respected by the United States.

Some of this is justified by members of the Senate as preventing illegal and unconstitutional breaches of privacy by allowing a U.S. account holder's data to be shared with a foreign government. Somehow though, these invasions of privacy are permissible if it is the U.S. Government, even if it is in breach of the laws of the countries we live in.

The only possible explanations I can come up with for this double standard are:

1. Congress is pursuing a policy to encourage/force U.S. citizens to renounce citizenship, which would be legally problematic in the context of *Afroyim vs. Rusk*.
2. Congress considers a non-resident citizen to have lesser rights than a resident citizen, which would be a suspect classification likely in violation of the 14th Amendment's equal protection clause.
3. The U.S. Government considers tax evasion *within* U.S. borders to be permissible because it benefits U.S. financial institutions, but it is opposed to tax evasion *outside* U.S. borders because it does not benefit U.S. entities.

The U.S. is ranked as #2 in the world for Financial Secrecy and #25 as a tax haven.[1] There is a wealth of information about tax shelters in Delaware and South Dakota that are used by both foreign and U.S. residents.

The Sometimes Discussed "Same Country Exception" Is Useless

The Honorable Rep. Carolyn Maloney and Democrats Abroad have often advocated for a "Same-Country Exception" to FATCA reporting. The proposed exception is unlikely to meaningfully improve the situation, given concerns by financial institutions about someone joining as a compliant customer and later going delinquent.

Under such an exception, would a Foreign Financial Institution be subject to penalties if a U.S. Person resident in the Netherlands opened their account and moved back to the United States without informing them? Would the Financial Institution be responsible for verifying residence on an ongoing basis? Would the Financial Institution bear the costs of this verification themselves?

In any case, the compliance risk would not be improve by a Same-Country Exception, and the compliance *costs* would remain the same or actually increase.

It is also worth noting as well that this would cause problems in the European Union's integrated financial markets—it is not uncommon for a Dutch financial institution to provide services to customers in Belgium or Germany and vice-versa. Any residency-based reporting exemptions would need to consider the European Union as a single jurisdiction to avoid creating further problems.

FATCA Discrimination Is not Prevented by the U.S. or our Places of Residence

It is important to note that U.S. courts view discrimination motivated by FATCA as being an *unrelated result* that is outside of their jurisdiction to prevent—Congress can pass the laws, but the United States is under no obligation to mitigate negative consequences.

In our countries of residence, we similarly lack legal protections—it varies by country, but we typically see a number of arguments for why the discrimination is permissible. The common arguments are:

1. The discrimination is effectively mandated by IGA with the U.S., so the U.S. should amend FATCA if the discrimination is problematic.
2. Enforcing non-discrimination statutes would pose an unreasonable burden for the business, and businesses have freedom of association to select or deny customers as needed.
3. While discrimination based on nationality or place of birth is illegal, discrimination on the basis of "U.S. Person Tax Status," inextricably linked to nationality or place of birth, is permissible.

[1] *https://www.taxjustice.net/country-profiles/united-states/*.

Because of FATCA's extraterritorial nature, there are now 9 million U.S. Citizens that are denied the legal protections necessary to live ordinary financial lives.

The Existing FATCA Regime Is Under Legal Scrutiny

While the negative effects of FATCA on individuals have not faced any meaningful challenge, an increasing number of legal challenges have occurred in our home countries.

In Canada, litigation seeking to challenge the constitutional compatibility of FATCA has been side-stepped with arguments of political expediency and fear of consequences related to opposing FATCA. That case is now headed to the Canadian Supreme court.

In the European Union, litigation challenging the compatibility of the FATCA IGAs with the EU General Data Protection Regulation (GDPR) is expected after parliamentary inquiry finishes—to date, European Parliament has expressed concern over political interference with independent regulators by the European Commission. Other challenges relate to the lack of measures to prevent discrimination against U.S. Persons in Europe—an insular minority.

In all of these cases, the plaintiffs are arguing that the FATCA IGAs are in clear breach of local laws, and the defenses are arguing that the severe penalties threatened by the United States justify ignorance of the principle of rule of rule of law.

If the United States wishes to be regarded as a world leader, rather than a hostile foreign power, it should respect the rights of its citizens and respect the rule of law and sovereignty of close allies like Canada and the European Union. It is unthinkable that pressure from the U.S. is causing fundamental legal rights to be trampled in the name of expediency.

Alternatives to FATCA

There are less destructive alternatives to FATCA that can be pursued—the OECD Common Reporting Standard (CRS), a new mechanism rolled out via the OECD, or a heavily modified FATCA that somehow protects the rights and interests of non-resident U.S. citizens.

In conjunction with the move to the Common Reporting Standard, the United States would also benefit from a move towards the global standard of Residence Based Taxation, rather than double-taxation on the basis of citizenship.

Conclusion

If Congress wishes to narrow the tax gap, and it is concerned about offshore evasion, further crackdowns and reporting requirements are unlikely to achieve the intended result. The harms of FATCA and the legal challenges to it underscore that any new measures are likely to face fierce legal and diplomatic opposition, possibly even in the United States.

Tax evasion by U.S. residents is indeed problematic, but to prevent this, a level of introspection is needed. Congress must respond to reports that the popular jurisdictions for tax evasion are now South Dakota and Delaware, rather than the Cayman Islands or Switzerland.

It must also take into account the reasons why tax compliance among non-residents is spotty at best: extraterritorial taxation of non-U.S. residents on non-U.S. source income is an aberration, compliance is expensive and difficult, taxpayer services are lacking or totally absent, and the continual worsening of conditions for Non-Resident Citizens, an insular minority, encourages hiding rather than compliance.

Alignment of the U.S. to the global standard of Residence Based Taxation coupled with a deemed-sale exit tax triggered on transition from Tax Resident to Tax Non-Resident would go a long way in encouraging compliance.

Residence based taxation can be made tight against abuse, generates tax revenue today, and it will protect the working and middle class.

I firmly believe that the concerns expressed in the past that a Wealth Tax is only workable in a system of Citizenship Based Taxation are unfounded—the strong outcry about the possible removal of the estate tax cost basis step-up indicates that the thing the wealthy fears most is the *realization of capital gains.*

If the United States were to take a page out of Canada's book and realize all unrealized gains when someone moves abroad, it would be fair, effective in raising revenue for the infrastructure plan, and it would make changes in residence for tax purposes *extremely* unattractive.

Above all else, I urge this Congress to resist the temptation to blame the tax gap on the offshore bogeyman and to introduce new extraterritorial reporting obligations. The last ten years has shown that FATCA has had limited efficacy in closing the tax gap while causing serious collateral damage to the working and middle class.

Engagement with the American diaspora is absolutely necessary. Our experiences must be heard, documented in the public record, and finally addressed by the government. We have valuable experiences from the countries we live in, and we are happy to point to examples of other tax systems that run smoothly.

Please, before recklessly implementing new reporting requirements, hold a hearing about the failings of the U.S. tax system with regards to Non-Resident citizens.

Thank you,
Nicholas Matthew Lee

LETTER SUBMITTED BY JAMES REGENT

U.S. Senate
Committee on Finance

Dear Senators,

I appreciate the opportunity to comment on the May 11 subcommittee hearing on "Closing the Tax Gap." I understand the importance of international taxation issues and the need for tax reform that ensures everybody contributes their fair share, especially the wealthy and those who evade taxes. That being said, I am deeply distressed after listening to this hearing; not once were the rights and needs of the individual tax-obliged non-resident American addressed, a huge voting-bloc estimated at around 9 million that has continuously been maligned and/or ignored in the Congressional dialogue.

Americans overseas have too long suffered the misperception that they are wealthy tax cheats living the high life while the average American suffers, a uniquely American politician conflation. Since the implementation of FATCA in 2010, non-resident Americans have been caught in the crosshairs of the U.S.'s bulldoze-effort to catch the elusive "tax cheat." Despite numerous efforts over the last decade by organizations (Democrats Abroad, Republicans Overseas, National Taxpayer Advocate, American Citizens Abroad, etc.) to provide guidance and research based evidence that provide a clearer picture of the non-resident diaspora, which has shown to be overwhelmingly average by wealth standards, I fear Congress is continuing the tradition of ignoring this already underrepresented group with the intent to push a legislative agenda that will further disenfranchise them.

The Pernicious Effects of FATCA on the Non-Resident American

While the original purpose of FATCA was to target high net worth individuals hiding money overseas, the lack of foresight that coincided with its implementation has created a nightmare for countless non-resident Americans, particularly Accidental Americans, those born in the U.S. to foreign parents that returned overseas at a young age. News from Europe since FATCA's implementation has reported that thousands of local bank accounts were and continue to be forcibly closed because they are tagged as a "U.S. taxpayer" but unable to provide a social security number, despite no real connection to the U.S.[1]

Countless lawsuits and complaints have been filed as a direct result of this rushed policy. French dual citizens lodged an official complaint to the European Commission for having been blacklisted by French banks due to the complexity of dealing with anyone U.S. related.[2] HM Revenue and Customs (HMRC) of the UK was sued over privacy breach associated with the compliance obligations imposed by the U.S. law that conflict with European privacy law.[3] Law suits are ongoing in Canada as well. Millions of other non-resident Americans face a similar fate if/when they are tagged as a U.S. person unless they disclose their social security number and agree to have their private personal information shared internationally, something any rational person would be hesitant to do due to pervasiveness of cyber crimes in the

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[1] *https://time.com/5922972/accidental-americans-fatca/.*

[2] *https://www.internationalinvestment.net/news/4005675/accidental-americans-sue-france-fatca-disclosure-rules.*

[3] *https://international-adviser.com/uk-taxman-faces-lawsuit-over-fatca.*

recent decade (something the U.S. should be all-too-familiar with the aftermath of the recent Colonial Pipeline ransomware attack). In terms of FATCA filing obligations I am thankful I do not have the savings to trigger any additional complicated paperwork, however I was personally denied a normal investment account years ago here in Japan when I considered trying to utilize some of my savings better (incidentally also how I found out about FATCA), while my British friend who accompanied me was able to open an account with no impediment. Instead of honest reflection in how to remediate these situations with meaningful reform, the stance of the U.S. has been to embarrassingly deny any cause and effect relationship and shift the blame to that of the country where the problems are occurring. My question is: are these the people Senator Whitehouse cavalierly joked about at the end of the hearing when he lamented over the missed opportunity to add a T to the end of FATCA?

It is imperative that Congress understand the situation of the overseas American and acknowledge the distinction between 1) offshore accounts of the "super rich" that live in the U.S. and hide their income earnings overseas and 2) the "offshore" accounts of non-resident Americans that reside and earn a living overseas and use these local bank accounts for their basic financial needs. Furthermore, the non-resident American should not be burdened with extraneous compliance obligations and should be excluded from any such reporting requirements, on an individual basis and for the financial institutions we need to use in order to lead our lives in our country of residence. Current discussions obsess over catching the "super rich" that they fail to address the extreme negative consequences such policies like FATCA, in its current form, have on the millions of "little fish" regular Americans living abroad.

The Uniquely Antiquated System of Citizenship Based Taxation and its Detriment on the Expat

Any discussion regarding international tax reform cannot be done without referencing that the issues outlined above regarding FATCA stem from the aberrant system of Citizenship Based Taxation (CBT), a system utilized solely by the U.S. and the small African country of Eritrea. Part of the injustice in the tax code that was mentioned during the hearing is, without a doubt, the tax breaks given all too often to the ultra rich and corporations. However, the other major injustices much less spoken about are the onerous filing requirements, *potential* tax liability incurred on non-resident Americans for income that is sourced in their country of residence, and the inability to achieve true control over our financial future due to suffocating direct and indirect restrictions on overseas accounts.

If the filer does not proactively take the steps to file with the proper exclusion (which is puzzlingly capped) or foreign tax credit that often needs to be prepared with a professional in order to be done properly (typically at increased cost than regular preparation since the forms are less commonly used), the citizen faces double taxation; this is a requirement no other industrialized country in the world puts on its non-resident citizens. A recent submission by Democrats Abroad[4] notes that a mere 6% of citizens live in what would be considered a "tax secrecy jurisdiction;" other research by American Citizens Abroad et al. has similarly shown that the overwhelming majority live in tax jurisdictions with taxes *higher* than the U.S. Barring any discrepancies in deductible expenses associated with social programs that the IRS refuses to acknowledge, this means that one way or another zero tax is typically owed to the U.S. since more is paid in the country of residence. Yet, personal testimonies presented via these advocacy groups claim some pay up to a month of their annual salary each year hiring an accountant to ensure tax compliance, despite owing nothing.

Personally, in my 11 years living abroad my income has never generated in excess the amount allowed by the Foreign Earned Income Exclusion, so because I pay taxes in my country of residence regularly and file U.S. taxes on time, I have zero tax liability to the U.S. Despite that, the effects of CBT are still detrimental, particularly with respect to suffocating tax compliance obligations, both FATCA and non-FATCA related. I am hesitant to own a home here out of fear of the tax event it would trigger in the U.S. if I ever sold it. I am afraid to even consider opening a small business because of the harm American small business owners overseas suffered thanks to GILTI in the 2017 TCAJ Act. More insidious, though, is how current tax law effectively prohibits using any type of local investment/retirement account

[4] *https://www.democratsabroad.org/carmelan/democrats_abroad_urges_the_senate_to_protect_and_support_americans_abroad_in_closing_the_tax_gap.*

because the investment vehicles (run-of-the-mill mutual funds of which many are identical to those in the U.S., just registered locally) are deemed "foreign," thus triggering onerous IRS paperwork and tax liabilities (referring specifically to locally established mutual funds deemed "PFICS," extremely unfair tax treatment and notoriously expensive forms to fill). This effectively paralyzes me and other Americans abroad when it comes to having any type of control over planning our financial future. We cannot open an account where we live without facing punitive U.S. tax (some may be refused in general), nor can we open one in the U.S. because we do not work nor have a legitimate U.S. address. I hear certain agreements with Canada and UK make it easier to do this, but that does not do me much good here in Japan.

Society has evolved globally over the past two decades, and movement around the world is more fluid than ever. However, U.S. tax policy is unique in the world in hindering its own people, who *could* act as unofficial ambassadors generating goodwill for the U.S., from realizing any type of long-term dream abroad. For 10 years Congress has not only refused to *act* on bipartisan and non-partisan calls for reform, it has refused to even discuss the issue. If something does rarely get proposed, it gets sent to committee to die (see Rep. Holdings 2018 Tax Fairness for Americans Abroad Act) or kicked down the road for "more research and information" (see any attempt to implement Residency Based Taxation (RBT), despite an abundance of solid research in the past few years). Ironically, both major parties like to claim the moniker "party for the working class," but it is becoming evidently clear that the definition does not extend to the working class non-resident American. This is evidenced by the lack of plan to provide tax-compliant Americans overseas any kind of vaccine access, and more recently demonstrated by recent news that Americans overseas will not be able to use the full amount of the new child tax credit. I would also note that while I received a stimulus check, I could not even cash it since Japan does not use checks and had no idea what to do with it. I assume this blame falls squarely on Japan or the individual since the U.S. Government did its bare minimum.

Meaningful Reform Recommendations

I believe strengthening the IRS to be able to update its infrastructure and effectively collect taxes that are owed is an important endeavor, however that energy needs to be directed in the right places.

Ms. Olson mentioned during the hearing that the use of new technology is important; Senator Thune also said that policy makers need to be reasonable about what is possible regarding closing the tax gap. Efficient allocation of resources, like new technology, should focus on what is realistically feasible. Implementation of a RBT system is necessary to not only bring the U.S. to the global standard and finally make American workers competitive globally, but would also facilitate that efficient (re)allocation of resources necessary to narrow the tax gap while simultaneously relieving the undue burden on the current non-resident American. The U.S. has over a thousand countries to learn from, and the Common Reporting Standard (CRS) serves a similar function of preventing the abuse of offshore accounts by reporting account holders with a tax residency elsewhere to that country of residence; even if Congress is reluctant to remove FATCA, it could be easily modeled off the CRS and heavily modified so that it protects the rights of non-resident Americans.

RBT should be implemented so non-resident Americans can live their lives with the financial freedom like any other person in their country of residence—without having to answer to multiple tax regimes that make them anxious about whether the IRS is going to come after them and threaten their passports or bank account. Renunciation of citizenship should not be the answer, but as I am sure you are aware, that is the route an extraordinarily growing number of average, responsible working class people have taken since 2010, not in order to "avoid tax" but in order to relieve them of the crippling effect of the unfair obligations imposed by their homeland and (re)gain control of their financial independence.

I implore Congress to read the research, data and reports from organizations like Democrats Aboard, Republicans Overseas, Association of Americans Resident Overseas, Stop Extraterritorial American Taxation, and in particular that of the ACA since 2017 (and currently being updated) to understand 1) the major issues that affect non-resident Americans as a result of the current U.S. tax system and 2) that the implementation of a robust residency based tax system that *protects against tax evasion while being revenue neutral* and not creating undue burden on the everyday American is entirely possible. Every other major country in the world has done it, it is now the U.S.'s turn.

Thank you for your time.
James Regent

LETTER SUBMITTED BY CECILE RIDDLE

U.S. Senate
Committee on Finance

I am an Australian citizen who has been notified by my bank that I am subject to U.S. tax laws. I have never lived in the USA (since I was 4 years old). Neither my parents (Maltese immigrants to the USA in the late 1940s) have owned properties or businesses in the USA.

Since becoming an Australian citizen at the age of twelve, I had thought I was Australian. I only retained my U.S. citizenship so that I could easily visit my elderly aunt in the U.S. She has now passed away and I have renounced my citizenship.

Now elderly, retired and in poor health, I'm severely distressed because I have to comply with U.S. tax laws. What's more, I find that my savings in superannuation are subject to U.S. taxation.

So far, attempting to comply has cost me $12,000 to engage a U.S. tax attorney to ensure I do it properly and don't get fined by the IRS. This tax law is unfair, unjust, and is causing me to spend an inordinate amount of time (10 months) collating documents to submit tax returns.

I plead with you to change this law immediately, so that I can spend what limited life I have left (I have cancer) in peace.

Thank you for your consideration.

Cecile Riddle

LETTER SUBMITTED BY RACHAEL RUBENSTEIN

May 26, 2021

U.S. Senate
Committee on Finance

Dear United States Senate Committee on Finance:

I am a tax attorney. Most of my practice involves dealing with IRS compliance-related issues and disputes. I've been in practice for 11 yrs. Early in my career, I ran a lower income taxpayer clinic, funded by an IRS grant. For the past 6 years, I have been in private practice representing small to mid-size businesses, higher income individuals, and U.S. persons who have foreign accounts/income/assets. As a side bar, in my experience taxpayers with assets outside of the U.S. are often not willful tax evaders. Many I represent are somewhat unsophisticated dual citizens, nonresidents, or relatively small business owners with operations in U.S. and MX. Most offshore compliance issues I deal with involve taxpayers who did not know about or understand all the complex reporting requirements under BSA, FACTA, etc. but who want to voluntarily disclosure prior noncompliance, or who were given bad advice from a former tax professional.

I write to share my opinion on a topic that was not discussed much during the hearing on May 11th—deteriorating customer service at the IRS and the agency's worsening inability to effectively handle compliance matters, routine taxpayer requests, refund claims, and taxpayer communications. From my perspective, except for processing of electronic returns for the current season and paying out individual stimulus payments, IRS has become pretty much dysfunctional in this COVID era. The agency has always been slow and inefficient with respect to how it handles compliance cases and routine customer service inquiries. But this past year has been awful, and I do not see how the agency can possibly recover without assistance.

For instance, I have *many* clients who have mailed tax payments to the IRS whose checks were not deposited *months* after being sent. For example, in late 2020, a cashier's check for over a million was sent by certified mail for an estimated tax payment. It took the IRS about six months to process/deposit that payment. I encourage all business and individual clients to pay online but not all consult me before making payments and paying online is not necessarily that simple for large tax payments. Lately, I have been advising individual clients making large payments to do so via wire transfer to IRS. But that too presents problems. For instance, about six month ago, I assisted an individual with making wire payments involving millions of dollars for assessed taxes. After we properly wired the funds, months went by and then the IRS sent the money back via mailed checks. It turned out that the payments were returned not because of anything we did wrong regarding the wires or payment designations but because of a glitch on IRS' end regarding how it processes certain types of tax payments. After investigating the matter and obtaining guidance, we promptly mailed the checks back with designation instructions. Nevertheless, those returned checks have yet to be processed, and the IRS proceeded to mail out automated collection notices threatening levy enforcement for the same "unpaid" taxes.

Further, IRS can no longer timely process mailed tax returns, including employment tax returns. Some taxpayers still must file paper returns—especially amended prior year returns to take advantage of COVID-related relief legislation— and some business taxpayers do not have the technology resources or knowledge to file 941s electronically. I have several business clients trying to resolve their IRS collection cases involving prior year liabilities. For them to negotiate a collection resolution, IRS requires them to be currently complaint with filing/deposit obligations. But the collection resolutions we proposed cannot be considered because IRS has yet to process 941 returns that were timely mailed for Q2 2020, Q3 2020, Q4 2020, and Q1 2021. The lack of timely return processing can create all sorts of downstream problems in the context of 941 returns. For instance, when a certain amount of time passes without a 941 tax return posting to a period where the taxpayer made timely payroll deposits in full, IRS automation regularly moves that quarter's deposits to other balance due quarters, so when the return finally does post, penalties are automatically assessed because the quarter was underpaid (due to the moved payments).

With respect to routine taxpayer correspondence, including claims for refund under COVID-related tax legislation (FFCRA and CARES), IRS simply cannot handle processing the mail or faxes it receives. Yet the agency continues to send automated notices to taxpayers, which do not take into account correspondence previously sent to the agency long ago. Communications I send by certified mail or FedEx are not responded to for *many* months. For some of my clients, *years* pass waiting on a response, especially cases involving penalty abatement requests (which taxpayers have a right to request under various Code provisions and Treasury regulations).

Regarding IRS field examinations and collections cases, Revenue Agents and Revenue Officers always ask for tons of documents in Information Document Requests or in Form 9297 Summary Contact Requests (usually requiring production of hundreds or thousands of pages of documents). But those employees have no efficient way to receive or appropriately consider such information electronically. Working from faxes or paper copies when dealing with accounting and bookkeeping records is bad practice—it leads to errors, unnecessary duplication of efforts, increased costs, and extended delays. It is very different in the private sector. For instance, when private parties in a controversy engage in the discovery process, they mostly exchange large volumes of data without printing, faxing, or using flash drives. Moreover, the parties are also usually able to utilize e-discovery tools to effectively analyze data exchanged or other more basic software to facilitate analysis. But IRS very rarely does anything like that in field exam and collection cases. Outside of the Office of Chief Counsel, IRS employees cannot accept file share invites or links to receive document productions electronically. Also, even now with changed Internal Revenue Manual (IRM) guidance regarding emailing, IRS collection and exam employees often refuse to communicate by email due to concerns about security and disclosure. Of course, we all must be mindful of security issues and IRC § 6103 does present a unique challenge for IRS. Nevertheless, IRS cannot continue indefinitely to rely on only fax and mail to effectively work these cases, especially when handling more complicated compliance matters.

Most frustrating for tax professionals is the current slow as molasses IRS Form 2848, *Power of Attorney,* processing at the IRS CAF Unit. I have had a practitioner e-services account set-up since 2011. Traditionally, it worked fairly well. I would submit a Form 2848 to the IRS CAF Unit by fax and after about 7–10 days it would be processed, allowing me to then pull from my e-services account various types of IRS transcripts electronically without having to call or mail IRS to obtain. Transcripts are necessarily for most cases, as they facilitate assessment of whatever situation I am hired to handle and allow me to issue spot key items that most clients cannot ascertain on their own. In January 2021, to comply with the 2019 Taxpayer

First Act, IRS developed a tool whereby tax professionals could submit Forms 2848 electronically. I was very excited about this improvement and began using this method to submit Forms 2848. But it has not worked out well. Forms 2848 submitted to IRS whether by fax or electronically take longer to process now than ever before. *Months* not weeks or days. Not unfrequently, despite properly submitting, Forms 2848 are simply not processed at all or are rejected for perceived errors.

This past week, I had 3 rejected improperly requiring me to send detailed responses explaining why they were correct with supporting IRM references or further documentation. In order for me to now obtain transcripts in a timely manner, I must call IRS and fax my Form 2848 while on the phone with an assistor who then goes through disclosure verification. During those calls, I can order transcripts to be delivered electronically to my secure IRS e-mailbox. Doing it this way eats up hours which means increased fees charged to clients who do not want to pay for time spent on this type of task. And because many tax professionals must go through this inefficient process (and due to other reasons related to IRS workforce challenges and high call volumes), the wait times on IRS phone lines are terribly long—averaging, in my experience, more than an hour to connect with a phone assistor and usually 1.5 to 2.5 hrs. to complete the call. Thankfully, the IRS now has a call back feature which has helped some with minimizing the actual time spent on hold. But so much time could be saved by IRS and practitioners with more prompt processing of Forms 2848.

Lastly, most IRS Accounts Management, Exam, Collection, and even Appeals employees are not well trained on tax procedure beyond the sections of the IRM (employee handbook) which they primarily operate under and are less trained when it comes to application of substantive law to specific case facts. As a result, way too much time is spent working on compliance cases that never seem to reach a resolution point until years have passed or the taxpayer litigates. I sympathize with the IRS workforce who seem overburdened and lacking in resources to effectively do their jobs. That said, the knowledge gap between the private sector and most of the IRS workforce is too vast. That knowledge gap combined with increased bureaucratic inefficiencies, longer case processing time frames, and an "enforcement mindset" leaves my clients with a very negative impression of the agency. That impression and their experiences overall do not accord with the goal of encouraging voluntary compliance.

Overall, the above problems at IRS have gotten worse each year I have been in practice and now appear unmanageable. As a result, I am filing more litigation cases. For some of these cases, the goal is simply to get someone competent—a DOJ Tax Division or IRS attorney—to consider the substance of the unresolved issue(s), or to deal with IRS confusion/mismanagement.

I am all for giving the IRS what it needs to appropriately carry out its core mission and functions. Presently, I worry about a lack of executive and congressional focus on the fundamentals. Before giving IRS greater access to third party reporting information and increased responsibilities around that or other expansion of duties and expectations, the agency needs more funding; increased oversight; better trained employees; and improved technology to handle what is already has in front of it.

The observations and opinions expressed herein are my own and not Clark Hill's. Thank you for your attention to this matter.

Respectfully,

Rachael Rubenstein

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U.S. Senate
Committee on Finance

24 May 2021

Please accept this as our submission with respect to the subject of the May 11, 2021 Senate Finance Committee Hearing: "Closing the Tax Gap: Lost Revenue From Noncompliance and the Role of Offshore Tax Evasion."

Part A—SEAT's Fifth Submission to the Senate Finance Committee

This is the fifth in a series of submissions from SEAT which have addressed issues raised in the Senate Finance Committee hearings since March 25, 2021, *http://seatnow.org/seat-home/seat-submissions/*.

Each of SEAT's previous submissions has invited the Senate Finance to consider the fact that U.S. citizens living outside the United States are profoundly (and in many cases negatively) impacted by the Committee's assumptions and proposals. To date, there has not been one single instance or witness which has acknowledged or considered that changes in U.S. tax law do impact Americans abroad. This omission continues to be in flagrant disregard of the fact that the United States imposes a separate and more punitive tax system on U.S. citizens living outside the United States than on U.S. citizens living in the United States.

Indeed, the Senate Finance Committee recognized the problem of the extraterritorial tax regime, at least as early as 2015. That is when the Senate Finance Committee Bipartisan Tax Working Group [1] on International Tax concluded their report [2] with the following paragraphs:

> According to working group submissions, there are currently 7.6 million American citizens living outside of the United States. Of the 347 submissions made to the international working group, nearly three-quarters dealt with the international taxation of individuals, mainly focusing on citizenship-based taxation, the Foreign Account Tax Compliance Act (FATCA), and the Report of Foreign Bank and Financial Accounts (FBAR).
>
> While the co-chairs were not able to produce a comprehensive plan to overhaul the taxation of individual Americans living overseas within the time-constraints placed on the working group, the co-chairs urge the Chairman and Ranking Member to carefully consider the concerns articulated in the submissions moving forward.

In other words, in 2015 the Senate Finance Committee recommended that that the negative effects of the extraterritorial tax regime be specifically considered.

Six years have passed and there is still no movement on overhauling the taxation of individual U.S. citizens living overseas, in spite of the clear directive from the International Tax Working Group. In fact, the situation for U.S. citizens abroad has gotten far worse. This is due in large part to the enhancements to the Subpart F regime in TCJA.[3] We informed the Senate Finance Committee in that regard in our submission dated April 22, 2021, available here.[4]

Part B—Recent Comments at the Senate Finance Hearings About FATCA and Citizenship-based Taxation

Furthermore, both FATCA and Citizenship Taxation continue to exacerbate the problems for Americans abroad. Both the April 27 and May 11 hearings contained comments and assumptions that reveal a level of ignorance of how the tax code impacts Americans abroad. There is a fine line between ignorance and malice.

With Respect to FATCA:

Senator Whitehouse concluded the May 11, 2021 hearing with following words: ". . . we need to continue to work on FATCA compliance. It's too bad that we couldn't put an extra 'T' on it. Then it would say FATCAT, which would be such an appropriate acronym for it."

Such an indescribably ignorant and appalling comment about the impact of FATCA on Americans abroad!

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[1] *https://www.finance.senate.gov/chairmans-news/finance-committee-bipartisan-tax-working-group-reports.*

[2] *http://www.finance.senate.gov/download/?id=E1FA3F08-B00C-4AA8-BFC9-7901BD68A30D.*

[3] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. 115–97. Known colloquially as The Tax Cuts and Jobs Act (TCJA).

[4] *http://seatnow.org/wp-content/uploads/2021/04/SEAT-Submission-Overhauling-International-Taxation.pdf.*

With Respect to Citizenship Taxation:

At the April 27, 2021 hearing Professor Gamage made the following comments about citizenship-based in the context of using citizenship-based taxation as the tool to enforce a wealth tax.

What follows is a transcript of part of Professor Gamage's testimony at the April 27, 2021 hearing:

> 1:15:10—Second exchange between Senator Cassidy and David Gamage
>
> Cassidy: Do you favor a worldwide wealth tax because that doesn't seem practical to me but that seems like people can move and they do. And capital can move, and it does. One example for example: I understand that China has an incredible capital flight and if there's any country that's done its best to surveille everything about every one of its citizens it's China and yet they have significant capital flight. So, would you recommend a global wealth tax?
>
> Gamage: The United States tax system—the current income tax is citizenship-based and taxes all worldwide income for citizens and always has. This is a key difference between the U.S. tax system and the French tax system. You can't escape the U.S. taxation without revoking your citizenship and paying a substantial exit tax. That's current law and it works quite well.
>
> Cassidy: And so the idea that somebody would give up their citizenship—I think one of the partners that made a lot of money from selling—some big Silicon Valley going public, renounced his citizenship and moved to Singapore, if I remember correctly. I'm gathering from you you feel as if that problem would be minimal.
>
> Gamage: It historically has been minimal and you pay a big exit tax . . .
>
> Cassidy: Historically we haven't had a wealth tax so I'm not sure we can use past history to predict future actions to kind of paraphrase the financial commercial.
>
> Gamage: Again, you pay a substantial exit tax under current law by revoking citizenship. Not many people do it. Some do. If they don't value the protections and services provided to citizens of the United States then fine. But the protections and services provided to extreme wealth are huge and most ultra-wealthy benefit tremendously from being United States citizens and having those protections and services, and it's fair to have them pay a reasonable amount of tax on that which they currently are not.

It's not clear what part(s) of the current extraterritorial tax system Professor Gamage thinks work "quite well", but from the perspective of Americans actually living outside of the U.S., the system is inherently dysfunctional. Numerous surveys[5] have been conducted which provide ample evidence that the U.S. tax laws (including the FATCA enforcement system) have resulted in handicapping Americans abroad whose financial lives are necessarily foreign to the U.S. These Americans have difficulty keeping bank accounts, saving for retirement, and running small businesses. Furthermore, while high net worth individuals might pay a substantial exit tax to renounce their U.S. citizenship, the threshold for this tax has been set at such a low level that middle-class Americans with retirement savings are often subject to this tax that was initially aimed at billionaires.

Part C—The Senate Finance Committee Continues a Long History of Misunderstanding and Prejudice Toward U.S. Citizens Abroad

Former Senator Max Baucus—one of Senator Wyden's predecessors as Chair of the Senate Finance Committee—was not immune to this prejudice. In 1995, he stated:

> [Americans] are going to great lengths, thousands of miles to other countries, to avoid paying their fair share. In a metaphorical sense, burning the flag, giving up what should be their most sacred possession, their American citizenship, to find a tax loophole. . . . These are precisely the sort of

[5] *See, for example,* "Survey Report: Effects of the Extraterritorial Application of U.S. Taxation and Banking Policies" (2021) at *http://seatnow.org/survey_report_intro_page/;* "I Feel Threatened by My Very Identity: U.S. Taxation and FATCA Survey" (2019) at *http://citizenshipsolutions.ca/2019/10/27/recently-released-survey-report-dispels-myth-of-the-wealthy-american-abroad-and-demonstrates-why-middle-class-americans-abroad-are-forced-to-renounce-us-citizenship/.*

greedy, unpatriotic people that FDR called malefactors of great wealth. . . . Let us not allow more of these rich freeloaders to get away.[6]

This profoundly ignorant comment from Senator Baucus, alongside many others expressed by other members of the United States Congress dating back to the Civil War right up to today,[7] expose longstanding and deep-seated prejudices against Americans who live outside the United States. Is it any wonder that these prejudices have been translated into extraterritorial taxation and banking policies that are highly damaging to Americans and green card holders living outside the United States? It appears that Senator Warren's wealth tax is premised on many of the same profoundly ignorant assumptions about U.S. citizens living outside the United States.

Part D—The Senate Finance Committee Must Include Witnesses With Knowledge of How FATCA and Citizenship Taxation Impact Americans Abroad

The Internal Revenue Code establishes three distinct U.S. tax regimes:

1. **Non-resident Alien Tax Regime:** Taxation on U.S. source income only.
2. **Tax Regime for U.S. Residents:** Taxation of U.S. residents on worldwide income (regardless of citizenship).
3. **Extraterritorial Tax Regime:** Taxation of the worldwide income, mostly non-U.S. source income of individuals who are U.S. citizens, who do not live in the United States and are tax residents of other countries. This is a separate and more punitive tax regime[8] than that imposed on U.S. citizens living outside the United States. To put it simply: The extraterritorial tax regime is based on citizenship regardless of economic or physical connection to the United States. Some—including the Committee witness Professor Gamage—refer to the extraterritorial tax regime as "citizenship-based taxation."

Every Senate Finance Committee Hearing has focused ONLY on the U.S. Tax Regime for U.S. Residents! The simple fact is that the United States is also operating an Extraterritorial tax regime which is applied to Americans abroad. The impact of tax reform on individuals subject to that Extraterritorial tax regime must be considered. SEAT respectfully requests that:

1. **There be a special Senate Finance Hearing for the sole purpose of providing evidence of how tax reform would impact Americans abroad; and**
2. **SEAT should be included as participants in that hearing.**

Part E—The Solution: Ending the U.S. Extraterritorial AKA Citizenship-Based Tax Regime

The best solution to this problem is for the United States to come into alignment with every other developed nation on the planet and **move to a residence-based taxation system for individuals.** Taxing non-resident citizens is "Mission Impossible," as it is impossible to fairly administer an extraterritorial tax system and afford non-resident U.S. citizens the rights guaranteed by the Taxpayer Bill of Rights (IRC § 7803(a)(3)), by multiple human rights instruments and by the U.S. Constitution.[9]

It is well past the time that the Senate Finance Committee act upon the call of the 2015 Senate Finance Committee Bipartisan Tax Working Group on International Tax, and finally accord to Americans living outside the United States the full attention, concern, and respect to which they are entitled as U.S. citizens. It is also well past time to put an end to the taxation and banking policies that penalize them so severely.

Thank you for your attention to these matters.

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[6] 3 Senate Committee on Finance, "Tax Treatment of Expatriated Citizens:" hearing on S. 453, S. 700, H.R. 831, H.R. 981, H.R. 1535 and H.R. 1812, 104th Congress 2 (July 11, 1995), *https://www.finance.senate.gov/imo/media/doc/Hrg104-795.pdf [https://perma.cc/7LDH-XW26]* (statement of Senator Max Baucus). *See also https://www.c-span.org/video/?66084-1/tax-treatment-expatriates.*

[7] Laura Snyder, "Taxing the American Emigrant," 74(2) *Tax Lawyer* 299 (2021). Available at SSRN: *https://ssrn.com/abstract=3795480,* at 317–20.

[8] *https://www.taxconnections.com/taxblog/the-united-states-imposes-a-separate-and-much-more-punitive-tax-on-u-s-citizens-who-are-residents-of-other-countries/.*

[9] Laura Snyder, Karen Alpert, and John Richardson, "Mission Impossible: Extraterritorial Taxation and the IRS," 170 *Tax Notes Federal* 1827 (March 22, 2021). Available at SSRN: *https://ssrn.com/abstract=3828673.*

Respectfully submitted by:

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