Ensuring Wealthy Tax Cheats Pay Taxes Owed: Financial Account Information Reporting

Myth vs. Fact

Tax cheats unfairly undercut their competitors and leave the rest of us with the tab – to the tune of $7 trillion over a decade. The president's account reporting proposal would help. When third parties report amounts to the IRS, they show up on a tax return about 95 percent of the time. But current law gives businesses a free pass to cheat. While the wages of nurses and firefighters are reported to the IRS by their employers, businesses are on the honor system.

A lack of third-party information reporting is why more than 50 percent of the income from sole proprietorships, partnerships, S corporations, and other pass-throughs is misreported. This misreporting accounts for about 58 percent of the tax gap. By comparison, only about 1 percent of wage income is misreported.

The president's proposal aims to crack down on tax evasion. But wealthy individuals and the banking industry – which has famously helped tax cheats hide their money – are misleading the public. The facts below aim to explain what's really being considered and to counter their organized and well-funded misinformation campaign.

Myth: "The Biden administration is proposing requiring financial institutions report to the IRS *transactions* of your business and personal accounts." [emphasis added]

Fact: The IRS won't see anyone's transactions. Financial service providers already report payments of $10 or more in interest. Under the proposal, they will simply report two numbers: total deposits (inflows) and total withdrawals (outflows).

Myth: Every account with more than $600 will be reported to the IRS.

Fact: Under the current proposal, accounts with deposits and withdrawals of less than $10,000 are not covered. When computing this threshold, Social Security and wages from certain payroll companies are excluded. For example, a person who deposits a paycheck plus rental income of $9,000 would not be subject to any new reporting.

To help preserve financial privacy, financial service providers could even round the amounts to the nearest $1,000.

Myth: The proposal is unnecessary because most income and expenses are already subject to information reporting.

Fact: Only wages are subject to comprehensive information reporting. Business income and expenses are largely exempt. The proposal would help flag the following types of cheating:

- A business has millions of dollars flowing into its accounts, but the IRS doesn't receive a return.
- A person's business account has large amounts of receipts, but they report only modest gross income on Schedule C.

- A business owner reports huge deductions, but their bank account shows minimal withdrawals or payments.

The president has proposed additional resources for the IRS to pursue tax evasion. But the IRS cannot audit its way out of a $7 trillion tax gap. Our tax code relies on voluntary compliance, and this proposal will help encourage it. Third-party reporting is regarded by the IRS, GAO, and academics as the best way to improve voluntary tax compliance because would-be tax evaders realize the IRS can see their true income.

This proposal will help create a more level playing field for all Americans. Today, honest businesses are at a competitive disadvantage because they are forced to compete against tax cheats.

Myth: The proposal raises taxes on those making less than $400,000.

Fact: The proposal doesn't raise taxes on anyone. It incentivizes tax cheats to pay what they owe under current law.

The proposal could even lower taxes for some people. When low-income taxpayers report their earned income (like earnings from self-employment), they can often claim larger tax refunds because of the earned income tax credit. They can also claim more Social Security benefits which increase with earnings.

Myth: The proposal will lead the IRS to hassle compliant taxpayers and freeze their accounts.

Fact: Businesses with typical deposits and withdrawals for their industry will face a lower risk of audit. And the IRS would not get any new authority to assess tax or freeze accounts.

Myth: The proposal will require nontraditional financial services like Venmo to start collecting Social Security numbers from casual users.

Fact: Because of the $10,000 threshold, the proposal would not require nontraditional financial services to start collecting Social Security numbers from casual users. The receipt of payments for goods or services from payment card settlement entities, such as Venmo, is already subject to reporting.

Myth: The proposal would be "devastating" for banks.

Fact: The biggest and most powerful banks in the world want Americans to believe they're still relying on legal pads and an abacus to perform basic functions. No one buys that. Most financial service providers already send customers statements that list deposits and withdrawals -- often electronically. Under the proposal, they would simply share this aggregate information with the IRS once a year – at the same time they report interest on the accounts to the IRS under current law. Financial industry experts have made clear that the proposal would be virtually cost-free to banks.