

## IRS random audits underestimate noncompliance among high-income taxpayers, new report says

A “substantial” portion of tax noncompliance among US taxpayers at the highest end of the income scale goes undetected in random audits conducted by the Internal Revenue Service, according to a new working paper whose authors include two members of the IRS’s research, applied analytics, and statistics team.

**URL:** <https://www.nber.org/papers/w28542>

The working paper, which was published by the National Bureau of Economic Research on March 22, notes that random audits are “well designed to detect common forms of tax evasion, such as unreported self-employment income, overstated deductions, and the abuse of tax credits.” But random audits miss noncompliance stemming from “sophisticated” strategies involving foreign intermediaries (such as undeclared foreign bank accounts) and the use of certain passthrough structures that are available to upper-income taxpayers. Addressing these forms of noncompliance “require[s] much more information, resources, and specialized audit staff than available to tax authorities for their random audit programs,” the paper states.

Based on analysis of data gleaned from IRS random audits, operational audits, and targeted enforcement initiatives, the paper finds that “unreported income as a fraction of true income rises from 7 percent in the bottom 50 percent [of taxpayers] to more than 20 percent in the top 1 percent, of which 6 percentage points correspond to undetected sophisticated evasion.”

All told, “36 percent of federal income taxes unpaid are owed by the top 1 percent” of taxpayers, the paper says, and “collecting all unpaid federal income tax from this group would increase federal revenues by about \$175 billion annually.”

The paper suggests that the Service can capture a greater portion of unpaid tax revenue by “facilitating whistle-blowing that can uncover sophisticated evasion,” and ramping up “specialized audit strategies” [such as its] Global High Wealth program and other specialized enforcement programs.”

The paper also notes that further research is necessary “to improve estimates of noncompliance at the very top in the United States.” Specific areas of focus could include, among other things, “the gray area between avoidance and evasion, a line which can be blurry at the top of the income distribution and for large corporations” and “strategic interaction between the tax authority and high-income individuals.”

### High-income audits a concern for TIGTA, taxwriters

Release of the working paper follows a recent audit report from the Treasury Inspector General for Tax Administration (TIGTA) that found, among other things, that the IRS does not make high-income taxpayers a priority in its efforts to recoup delinquent tax payments, that the agency does not have a strategy to address delinquencies among high-income taxpayers, and that it does not consider the fact that a taxpayer has a high level of income as a primary factor in determining whether a delinquency is collectible.

**URL:** <https://www.treasury.gov/tigta/auditreports/2021reports/202130015fr.pdf>

IRS audit rates of high-income taxpayers have been an ongoing concern among congressional Democratic taxwriters, and Commissioner Charles Rettig faced questions about the issue at a March 18 House Ways and Means Oversight Subcommittee hearing on the 2021 tax filing season. Rettig acknowledged that audit rates among taxpayers with more than \$1 million in annual income have fallen in recent years. He noted, though, that the IRS has lost 15,000 enforcement personnel since 2010, and that in 2010, the rate of audits in process for taxpayers making more than \$10 million was 23 percent.

Rettig also alluded to the new working paper, which at the time of the hearing was just days away from its formal release, telling the panel that it would show the Service needs to beef up its enforcement team with agents who specialize in offshore tax strategies and other compliance issues unique to high-income individuals. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 13, Mar. 19, 2021.)

[URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210319\\_2.html](https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210319_2.html)

### **Neal promises Ways and Means hearing**

The recent reports on taxpayer noncompliance prompted House Ways and Means Committee Chairman Richard Neal, D-Mass., and Select Revenue Measures Subcommittee Chairman Mike Thompson, D-Calif., to issue a statement March 23 in which they pledged to “work with urgency to create an equitable system that holds tax cheats accountable.”

[URL: https://waysandmeans.house.gov/media-center/press-releases/ways-and-means-chairs-statement-tax-evasion-wealthy-and-tax-gap](https://waysandmeans.house.gov/media-center/press-releases/ways-and-means-chairs-statement-tax-evasion-wealthy-and-tax-gap)

Neal and Thompson also announced plans to schedule a hearing “to better understand how Congress can hold to task the wealthy taxpayers who are exploiting and undermining our tax system.”

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