Tax gap could top $1 trillion a year, Rettig says

The federal tax gap – the difference between the amount of taxes owed to the government and the amount collected – likely is higher than official estimates suggest and could equal or even exceed $1 trillion a year, Internal Revenue Service Commissioner Charles Rettig told Senate taxwriters this week.

Speaking at an April 13 Senate Finance Committee hearing on the 2021 tax filing season, Rettig explained that the IRS's most recent published estimate, which covers the years 2011-2013, puts the gross annual tax gap at $441 billion. An updated estimate is expected next year.
URL: https://www.irs.gov/newsroom/the-tax-gap

But that figure does not provide an adequate indication of current levels of noncompliance, he said, in part because it does not reflect the impact of cryptocurrency – something that was not on the government's radar in 2011. Rettig noted that there currently are more than 8,600 virtual currencies in the marketplace with a total estimated value of $2 trillion.

Official estimates also likely do not reflect the full extent of underreporting by taxpayers on foreign-source income, passthrough income, offshore income, and illegal-source income, Rettig said. Citing a recently released report (whose authors include two members of the IRS's research, applied analytics, and statistics team), Rettig stated that noncompliance among the top 1 percent of individual taxpayers likely reduces federal receipts by an estimated $175 billion a year. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 14, Mar. 26, 2021.)
URL: https://www.nber.org/papers/w28542
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210326_6.html

Budget and legislative remedies

Finance Committee Chairman Ron Wyden, D-Ore., noted that Rettig's estimate confirms the committee's own suspicions about the true scope of noncompliance among certain segments of taxpayers and announced that for as long as he holds the gavel the panel's annual filing season hearings will "put a special focus on what the IRS has done to catch the cheats and close the tax gap." He also asked Rettig to recommend actions Congress can take, both in terms of providing additional budget resources and making legislative changes, to help the Service address the problem.

Budget: Rettig replied that tackling noncompliance requires a "multifaceted approach." He commented several times during the hearing that the Service is constrained by a lack of enforcement resources – specifically, that the Service's headcount in audit and enforcement has fallen by 17,000 over the past 10 years, a situation several Democrats on the panel attributed to congressionally mandated cuts to the IRS budget.

With a $1 billion increase in its enforcement budget, Rettig said, the Service could hire 4,875 front-line personnel (and their counterparts in the Taxpayer Advocate Service, Appeals Division, and Office of Chief Counsel) and modernize its information technology systems to enhance its ability to identify the increasingly

sophisticated financial transactions and tax-avoidance strategies in the marketplace. (The Biden administration called for a $1.2 billion increase in the Service's base funding allocation for fiscal year 2022 in the preliminary spending request for federal departments and agencies it released on April 9. For prior coverage, see *Tax News & Views*, Vol. 22, No. 19, Apr. 9, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210409_5.html

Rettig also commented in his opening statement that multi-year budgeting for the IRS (as opposed to an annual appropriation) would give the Service the stable funding source it needs to carry out its planned technology upgrades.

Finance Committee Democrat Elizabeth Warren of Massachusetts said that she plans to introduce legislation that would classify the enforcement component of the Service's budget as mandatory spending, an approach she said would provide "more stable funding that's targeted to catching the biggest fish."

Rettig agreed that Warren's proposal would bolster the Service's efforts to address the tax gap.

"Mandatory, consistent, adequate, multi-year funding allows us to plan appropriately," Rettig said. "Every time we go into hiring, we have a concern over whether we can actually feed those folks the next year."

Information reporting: In terms of tax code changes, Rettig told the panel that Congress could help the Service narrow the tax gap by tightening information reporting requirements "across all lanes." He noted that in areas of the tax code where there are "substantial" information reporting requirements, "about 99 percent of income items" are captured. That figure drops to about 45 percent in areas where information reporting is not required, he added.

There was bipartisan discussion among taxwriters about information reporting specifically targeting cryptocurrency transactions – something Chairman Wyden said presents "huge new opportunities" for tax noncompliance.

Finance Committee Republican Sen. Rob Portman of Ohio said he is working on bipartisan legislation that would define cryptocurrency for tax purposes and asked Rettig for suggestions on what types of reporting requirements would be most useful.

Rettig replied that the Service could provide technical guidance on that issue and noted that the 2020 Form 1040 specifically asks whether a taxpayer engaged in cryptocurrency transactions. He told Portman that the cryptocurrency world is "replicating itself constantly" and that many elements are "not visible by design." He also noted that the cybercrimes unit of the IRS's Criminal Investigations division has been "spectacular operating in the dark web engaging with cryptocurrency-related transactions."

In an exchange with Sen. James Lankford, R-Okla., Rettig noted that the Service and the Treasury Department are working on guidance to help clarify when a cryptocurrency transaction is considered a taxable event.

Addressing a different reporting initiative, Rettig said in response to a question from Democratic taxwriter Sheldon Whitehouse of Rhode Island that the Service is training front-line personnel on a recently enacted provision that requires certain business entities to report their beneficial owners to the Treasury Department's Financial Crimes Enforcement Network. The reporting requirement was one of several anti-money laundering provisions included in a defense spending bill that took effect in the final weeks of the Trump administration after the House and Senate voted to override then-President Trump's veto of the underlying legislation. (For details, see *Tax News & Views*, Vol. 22, No. 1, Jan. 8, 2021.)
URL: https://newsletters.usdbriefs.com/2021/Tax/TNV/210108_3.html

Whitehouse asked that the IRS brief the committee on its efforts to implement the reporting provision.

Other legislative recommendations: Rettig also told the panel that Congress could address the tax gap by requiring electronic filing for most tax returns, providing the IRS with authority to address correctable errors on tax returns, and giving the Service regulatory authority over paid tax return preparers.

Audit priorities

Sen. Whitehouse asked Rettig about a recent audit report from the Treasury Inspector General for Tax Administration (TIGTA) which concluded, among other things, that the IRS does not make high-income individuals a priority in its efforts to recoup delinquent tax payments and that the agency lacks an overall strategy to address noncompliance among these taxpayers. According to the report, the Service's recovery rate for unpaid balances of high-income taxpayers is only 39 percent, resulting in a revenue loss of $2.4 billion. Whitehouse also noted that the report suggests that filers claiming the earned income tax credit (EITC) are more likely to be audited than wealthy taxpayers.
URL: https://www.treasury.gov/tigta/auditreports/2021reports/202130015fr.pdf

Rettig replied that he disagreed with the TIGTA report "entirely" and said the assertion that the Service does not prioritize collecting unpaid balances from wealthier taxpayers is "absolutely false." He also told Whitehouse that the 2019 IRS Data Book shows that the audit rate for taxpayers with income greater than $10 million exceeded 8 percent, compared to an audit rate of 1.12 percent for EITC claimants. Rettig said he and his staff were willing to meet with Whitehouse and other interested Finance Committee members to discuss the information in the data book.
URL: https://www.irs.gov/pub/irs-pdf/p55b.pdf

Advance child tax credit payments

Some senior Republicans on the panel addressed the Service's capacity to implement expansions to the child tax credit that were enacted in the American Rescue Plan Act of 2021 (P.L. 117-2), the $1.9 trillion economic relief package that President Biden signed into law last month.

Most notably, the IRS is responsible for implementing a provision in the new law that makes the child tax credit available to taxpayers in advance "periodic" payments beginning on July 1 and continuing through the rest of 2021. That provision also requires the Service to launch a new online portal that will allow taxpayers to opt out of receiving advance payments and to provide information regarding changes in income, marital status, and number of qualifying children for purposes of determining each taxpayer's maximum eligible credit.

Rettig told the panel that the IRS currently is on track to launch the portal and begin implementing the advance payment program by the statutory deadline.

In an exchange with Sen. Charles Grassley, R-Iowa, Rettig said that the advance payment program has required an investment of $391 million and between 300 and 500 IRS employees will be involved in its operation.

Grassley asked about the potential for fraud and improper payments under the new program. Rettig replied that there is "definitely a risk," although it could not be quantified. He said that the Service intends to employ deterrence measures to avert potential fraud and pursue enforcement measures to address any actual detected fraud. (He also stated at several points during the hearing that the bulk of improper child tax credit and earned income tax credit claims is attributable to unscrupulous tax return preparers and that Congress could address this problem by allowing the IRS to regulate paid return preparers.)

Finance Committee ranking member Mike Crapo, R-Idaho, expressed concern that the portal may be of limited use to individuals in low-income and rural communities with poor internet access. Rettig replied that these taxpayers would be able to inform the IRS of any status changes that affect their eligibility for the credit (or the amount of credit they're entitled to receive) by submitting a form in the mail or by visiting an IRS office.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP