

Senate taxwriters wrestle with tax gap, audit and enforcement issues

A recent statement by IRS Commissioner Charles Rettig that the annual tax gap – revenue owed to government but not collected – could be more than twice as high as the most recent official estimate of \$441 billion was the focus of much discussion at a Senate Finance subcommittee hearing May 11 as lawmakers sought to understand the IRS’s enforcement goals and funding needs and the feasibility of identifying and addressing taxpayer noncompliance.

Estimate or guesstimate?

Rettig made headlines April 13 when he told Senate taxwriters that the tax gap could equal or even exceed \$1 trillion a year. He said the IRS’s official estimate – which is based on data from tax years 2011-2013 – does not account for cryptocurrency holdings or reflect the full extent of underreporting by taxpayers on foreign-source income, passthrough income, offshore income, and illegal-source income. (For prior coverage, see *Tax News & Views*, Vol. 21, No. 20, Apr. 16, 2021.)

[URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210416_3.html](https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210416_3.html)

At this week’s hearing, Barry Johnson, the acting chief of research and analytics at the IRS, told the Subcommittee on Taxation and IRS Oversight that a current estimate of the gap would also take into account the gig economy, abusive conservation easements, microcaptive insurance transactions, and other factors.

However, Nina Olson, who served for 18 years as the National Taxpayer Advocate, told the senators she is “very disturbed about guesstimates about the tax gap,” saying this sends a message to IRS employees that “there are lots of people out there cheating and so whomever they see they may view as doing that.” (Finance Committee ranking member Mike Crapo, R-Idaho, also asked for clarifications about the size of the tax gap and how it is calculated in a recent letter to Rettig.)

[URL: https://www.finance.senate.gov/ranking-members-news/crapo-calls-for-clarity-on-irs-tax-gap-estimates](https://www.finance.senate.gov/ranking-members-news/crapo-calls-for-clarity-on-irs-tax-gap-estimates)

How much bang for the enforcement buck?

Sen. John Thune of South Dakota, the subcommittee’s ranking Republican, emphasized that Republicans agree with their Democratic colleagues that the tax gap must be addressed.

“No one at any income level should believe they are safe in cheating on their taxes,” Thune said.

However, Thune also pushed back on the size of the funding increase President Biden has requested for the IRS as part of the American Families Plan, saying he believes \$80 billion over 10 years – which the White House estimates will bring in \$700 billion in additional tax revenue over the same period – is too much. The administration’s estimate differs significantly from Congressional Budget Office figures published last July, which estimated that increasing IRS funding for examinations and collections by \$40 billion over 10 years would increase revenues \$103 billion.

[URL: https://www.cbo.gov/publication/56467](https://www.cbo.gov/publication/56467)

Recommendations

A number of witnesses at the hearing advocated for increased funding and improved technology at the IRS and more focused auditing, in line with the goals President Biden has laid out in his preliminary budget request and his American Families Plan. (For details on the president’s preliminary budget request, see *Tax News & Views*, Vol. 21, No. 19, Apr. 9, 2021. For details on the American Families Plan, see *Tax News & Views*, Vol. 22, No. 23, Apr. 30, 2021.) Several emphasized the need for long-term funding stability for the agency, noting that a one-year appropriations boost will not be sufficient.

[URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210409_5.html](https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210409_5.html)

[URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210430_1.html](https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210430_1.html)

Olson warned that a short-term improvement is unlikely and laid out the IRS’s challenges in her testimony, saying that addressing the tax gap will require a “transformational change” at the agency.

“That change 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,” Olson stated.

Charles Rossotti, who served as IRS commissioner from 1997 to 2002 and now collaborates with two other former IRS leaders on a project called Shrink the Tax Gap, recommended an additional Form 1099 information report on the business income of taxpayers in the top income quartile and their passthrough businesses, which would provide a summary of deposits and withdrawals from the taxpayer’s bank accounts. In his testimony, Rossotti stated that compliance is as low as 50 percent where there is no reporting and that the addition of this Form 1099 would make this “low visibility income” more similar to that reported on W-2s and current 1099s.

In response to Rossotti’s proposal, Olson argued that while additional reporting might be helpful in shrinking the tax gap, “the IRS today lacks the expertise and systems to achieve this level of sophisticated tax administration” and requiring the new Form 1099 only for taxpayers in the top quartile of income would imply a presumption that these individuals are evading taxes. Instead, Olson recommended that Congress require financial institutions to report deposits and withdrawals on all accounts designated by the taxpayer as used for business, regardless of their income level, and prohibit the IRS from using this data in the Automated Underreporter Program.

— Storme Sixeas
Tax Policy Group
Deloitte Tax LLP

This document contains general information only and Deloitte is not, by means of this document, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this document.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the “Deloitte” name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.