Democratic, GOP taxwriters split over White House proposals to reduce 'tax gap'

Debate broke along partisan lines as House and Senate taxwriters quizzed leading Treasury and Internal Revenue Service officials during separate hearings to explore proposals in President Biden's fiscal year 2022 budget blueprint aimed at addressing the "tax gap," the difference between the amount of tax owed to the government and the amount actually collected.

Overview

The IRS's most recent published estimate, which covers the years 2011-2013, puts the gross annual tax gap at $441 billion; however, IRS Commissioner Charles Rettig has indicated that the actual amount of uncollected tax likely is higher than official estimates suggest and could equal or even exceed $1 trillion a year. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 20, Apr. 16, 2021. A background report on the tax gap and legislative proposals to address it is available from the Joint Committee on Taxation staff.)
URL: https://www.irs.gov/newsroom/the-tax-gap
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210416_3.html
URL: https://www.jct.gov/publications/2021/jcx-30-21/

The Biden administration argues that the government could recoup a significant chunk of the forgone revenue by beefing up the IRS's enforcement budget to enable the agency to better identify sophisticated tax-avoidance transactions and by expanding information reporting and other rules to promote taxpayer compliance. To that end, the administration's FY 2022 budget blueprint, which was released May 29, calls for a 10.4 percent increase in IRS funding over current levels, including $6.7 billion in new discretionary spending for enforcement efforts over the 10-year budget window, as well as $72.5 billion in mandatory spending for enforcement and compliance. The budget package also includes specific compliance-related proposals such as additional reporting on financial accounts, expanded broker information reporting on cryptocurrency assets, and increased electronic return filing. (For a detailed discussion of what's included in the president's budget package, see *Tax News & Views*, Vol. 22, No. 28, May 29, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210529_1.html

At a Senate Finance Committee hearing on June 8 and a joint hearing of the House Ways and Means Select Revenue Measures and Oversight subcommittees on June 10, Democrats argued that the administration's proposals would shrink the tax gap and promote equity within the tax system by ensuring that taxpayers across the income spectrum pay what they legally owe. Republicans generally countered that a significant expansion of the Service's enforcement division would create a massive new bureaucracy and that the proposed new information reporting requirements would be unduly burdensome – particularly for small businesses – and could put taxpayer privacy at risk.

IRS Commissioner Rettig was the sole witness at the Finance Committee hearing. Treasury Deputy Assistant Secretary for Tax Policy Mark Mazur and IRS Deputy Commissioner for Services and Enforcement Doug O'Donnell appeared before the Ways and Means panels.

Selective enforcement?

Finance Committee Chairman Ron Wyden, D-Ore., and Ways and Means Oversight Subcommittee Chairman Bill Pascrell, D-N.J., argued at their respective hearings that the current rules have essentially created two tax systems – one for more affluent taxpayers, who have the resources to engage in complex financial transactions and often have sources of income that currently are not subject to strict third-party reporting requirements, and one for lower- and middle-class taxpayers, whose income is derived primarily from wages and is routinely reported to the IRS.

Treasury's Mark Mazur told Pascrell that the tax proposals in the president's budget blueprint – such as taxing long-term capital gains at ordinary rates for certain upper-income taxpayers and eliminating the step-up in basis for certain inherited assets – are aimed at reducing this disparity by equalizing the tax treatment of wage and capital income.

Sen. Wyden cited as evidence of the perceived divide in the IRS's treatment of taxpayers a 2020 report from the Treasury Inspector General for Tax Administration (TIGTA) which found that for tax years 2014 through 2016, the Service did not audit nearly 900,000 high-net-worth individuals who failed to file returns and whose combined unpaid tax bills totaled an estimated $45.7 billion.
URL: https://www.treasury.gov/tigta/auditreports/2020reports/202030015fr.pdf

Commissioner Rettig replied that "every high-income nonfiler from the 2016 tax year forward is [now] involved in compliance actions" with the IRS. He also noted that there are legislative proposals currently in Congress that would make nonfiling over multiple years a felony rather than a misdemeanor – a change that, if enacted, would further enhance the Service's enforcement efforts. (The majority of the felony cases the IRS pursues result in incarceration, he told Wyden.)

Wyden also pointed to data suggesting relatively low audit rates for partnership returns – a situation Rettig attributed to the combined effects of a steady reduction in IRS enforcement personnel over the past decade and a rapid expansion in the number of partnership returns being filed.

The IRS "can't touch 4.2 million partnership returns with just 6,500 field revenue agents Service-wide," he said.

In an exchange with House taxwriter Brad Schneider, D-Ill., at the Ways and Means hearing, the IRS's Doug O'Donnell noted that returns for partnerships and S corporations have become increasingly complex in recent years as a growing number of these entities have begun to operate globally.

A more specialized IRS workforce

Commissioner Rettig told members of the Finance Committee that the administration's proposals to provide consistent, multi-year funding for the IRS would allow the agency to expand its audit and enforcement operations to more effectively shrink the tax gap and create an even playing field for taxpayers across all income levels.

Rettig said in an exchange with Chairman Wyden that if the funding is approved, the Service intends to hire agents who have specialized experience in high-net-worth and global high-wealth tax issues, large passthrough returns, large and ultra-large corporate tax compliance issues, employment tax field examinations and correspondence examinations, transfer pricing, nonfiler virtual currency issues, Bank Secrecy Act issues, and abusive transactions.

The Service's goal, he said, is to bring on mid- and senior-level professionals who can train existing staff as well as work cases.

At several other points during the hearing, Rettig told the panel that the IRS would be in a better position to attract highly skilled agents and could implement its new enforcement programs more quickly if it had direct hiring authority.

"Without direct hiring authority, I cannot keep these people interested in coming on board for a three, six, or nine-month period," he said.

GOP concerns: Some House Republican taxwriters at the Ways and Means hearing appeared wary of the administration's proposals.

In his opening statement, Select Revenue Measures Subcommittee Chairman Adrian Smith, R-Neb., expressed concern that Congress would be ceding its oversight authority by approving the administration's request for such a large mandatory spending allocation for the Service. He argued that Congress should instead find targeted ways through the regular appropriations process to make sure the agency has a measure of long-term funding certainty.

GOP taxwriter Tom Rice of South Carolina raised a similar concern in an exchange with Treasury's Mark Mazur, who commented in response that multi-year funding is critical for the Service and that the Ways and Means Committee would still have an oversight role over the IRS and its spending practices even if the mandatory funding component of the agency's budget is approved.

Smith and Oversight Subcommittee ranking member Mike Kelly, R-Pa., raised questions in their respective opening statements about whether the proposed increase in enforcement funding would actually yield the $700 billion in additional tax revenue (over 10 years) that the administration projected in its budget estimates.

In a subsequent exchange with Smith, Mazur expressed confidence in the IRS's estimate that every $1 in additional enforcement spending would yield between $4 and $5 in additional revenue.

Too much information?

Finance Committee ranking member Mike Crapo, R-Idaho, criticized as overly broad a budget proposal that would require financial institutions to report gross inflows and outflows of financial accounts, with a breakdown for physical cash, transactions with a foreign account, and transfers to and from another account with the same owner. An exception would apply for accounts with a gross flow below a threshold of $600.

Crapo also contended that the proposal would not have broad public support, noting that a significant expansion of Form 1099 reporting requirements that was enacted in 2010 as part of the Patient Protection and Affordable Care Act was repealed the following year.

Commissioner Rettig replied that the account information that financial institutions would be required to report is already available to the IRS whenever it begins an examination and he reminded Crapo that TIGTA, the Taxpayer Advocate Service, and the Government Accountability Office provide the necessary oversight and backstops to ensure the protection of taxpayer privacy.

He also noted that the increased information reporting, when combined with planned enhancements to the IRS's information technology systems (one of the investments the Service would make if the administration's proposed funding increase is approved) would make it easier for the agency to determine which taxpayers need to be audited and which taxpayers do not.

Treasury's Mark Mazur and the IRS's Doug O'Donnell advanced similar arguments at the Ways and Means Committee hearing, noting that the reporting requirement is intended to flag what Mazur called "gross levels of noncompliance" – for example, taxpayers who have high amounts of money flowing into and out of their accounts but who report relatively low amounts of income on their tax returns.

Ways and Means Committee Republican Brad Wenstrup of Indiana commented in an exchange with Mazur that the reporting requirement could pose undue burdens for small community banks. Mazur replied that smaller institutions could face certain one-time costs but said the administration could work with those institutions to minimize potential burdens.

Cryptocurrency reporting

The administration's budget blueprint includes a proposal that would require brokers, including entities such as US crypto asset exchanges and hosted wallet providers, to report information relating to certain passive entities and their substantial foreign owners. This would allow the IRS to require a broker to report gross proceeds and other information with respect to sales of crypto assets for customers, and, in the case of certain passive entities, their substantial foreign owners.

Republican Finance Committee member Rob Portman of Ohio asked Commissioner Rettig whether he believes that the IRS has authority to issue regulations related to broker information reporting on cryptocurrency transactions.

Rettig replied that authority to issue regulations in this area would have to come from Congress.

“We get challenged frequently and to have a clear dictate from Congress on the authority to collect that information is critical,” he said, adding that these transactions are “designed to stay off the radar screen.”

Hearings set to discuss full budget package

Finance Committee members will focus on the administration’s FY 2022 budget blueprint more broadly at a hearing scheduled for June 16. The full Ways and Means Committee will consider the budget blueprint at its own hearing scheduled for June 17.

Treasury Secretary Janet Yellen will be the sole invited witness at both hearings.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP