



Unrigging the Economy Will Require Enforcing the Tax Laws

By Seth Hanlon March 2020

Center for American Progress



Unrigging the Economy Will Require Enforcing the Tax Laws

By Seth Hanlon March 2020

Contents

1 Introduction and summary

3 The United States loses hundreds of billions of dollars each year to unpaid taxes

- 3 From 2011 to 2013, the United States lost \$381 billion in revenue annually due to tax evasion and noncompliance
- 4 The biggest portion of the tax gap is business owners underreporting their income
- 5 Virtually all wage income of workers is properly reported, but this is not the case for other forms of income
- 6 High-income taxpayers are primarily responsible for the tax gap
- 8 The official tax gap estimates are only part of the story
- 10 The IRS cannot adequately enforce the tax code given current resources and priorities
- 14 IRS audit priorities are badly out of balance

17 Strategies to improve tax enforcement

- 17 Invest in IRS tax enforcement
- 19 Change budget scorekeeping rules to more accurately account for better tax enforcement
- 21 Reprioritize IRS enforcement resources and rebuild the 'wealth squad'
- 23 Expand the scope of information reporting and withholding
- 25 Improve employment tax enforcement
- 26 Better regulate tax preparers and expand VITA programs
- 26 Improve tax gap estimates and their presentation

29 Conclusion

30 Endnotes

Introduction and summary

A flurry of recent news stories highlights the scourge of tax dodging by wealthy individuals and large corporations.

Some of the stories have involved brazen criminal tax evasion on a shocking scale, including revelations that Paul Manafort, President Donald Trump's former campaign chair, managed to hide more than \$30 million of income that came from clients in Ukraine; he used a byzantine network of shell corporations and secret offshore bank accounts.¹ Despite a conspicuously extravagant lifestyle, Manafort was only caught after being swept up in an investigation of Ukraine's deposed leader.²

Other news reports chronicled sophisticated techniques used by extraordinarily wealthy people to defeat the Internal Revenue Service (IRS), including the story of Georg Schaeffler, a billionaire who allegedly used a complex series of transactions to avoid taxes on billions of dollars of income from loan cancellations. When the IRS challenged him, he litigated the agency into submission.³ There were the Wall Street banks and hedge funds that, according to U.S. Senate investigators, used financial derivatives to shelter \$34 billion in investors' profits from ordinary tax rates.⁴ And then there is the Trump family, which allegedly engaged in outright fraud to dodge some \$500 million in taxes when transferring wealth between generations.⁵

Other shocking stories highlight the tactics that large, multinational corporations employ to report their profits in corporate-friendly tax havens instead of in the United States.⁶

These stories, which are just the tip of the iceberg, have a common thread running through them: When it comes to policing tax compliance among wealthy individuals and corporations, the IRS is badly outgunned.

As IRS researchers highlighted in a recent report, the United States lost an average of nearly \$400 billion per year in unpaid taxes from 2011 to 2013. Moreover, over the past decade, Congress has made the problem much worse. It has given the IRS new

responsibilities while sharply cutting the agency's budget. The IRS has lost more than one-third of its enforcement personnel.

The tax system relies on voluntary compliance. The good news is that the overwhelming majority of Americans are honest and in fact view paying taxes as a civic duty and patriotic.⁷ But when some taxpayers cheat and get away with it, it undermines other Americans' faith in the integrity and fairness of the system. It makes them feel like "chumps."⁸ Moreover, awareness that other people are cheating can make people more likely themselves to cheat. Not only is tax evasion often linked to corruption and other crimes,⁹ but it also erodes confidence in U.S. institutions in general.

The bulk of revenue losses from tax noncompliance, and the broader problem of aggressive tax avoidance, is from high-income individuals and multinational corporations. These wealthy individuals and entities have opportunities to avoid taxes that are not available to ordinary workers, for whom taxes are withheld directly and automatically from every paycheck. Consequently, the weakening of tax enforcement increases inequality. It also shortchanges the federal government, draining revenue needed for critical services and investments.

This report assesses the problem of tax evasion and avoidance. It explains how the IRS lacks resources, as well as misdirects the resources it does have, and suggests ways to improve tax enforcement and ensure that policymakers can better address the issue.

The United States loses hundreds of billions of dollars each year to unpaid taxes

The most systematic effort to measure the amount of revenue that the United States loses every year in unpaid taxes is the Tax Gap report produced periodically by the National Research Program (NRP) of the IRS. The tax gap results from both intentional evasion—people cheating on their taxes—and unintentional noncompliance. The report’s estimates are based primarily on samples of tax returns selected for audit, with additional adjustments.¹⁰ The tax gap analysis is a major undertaking, with results not published until several years after the years studied. In September 2019, the IRS published its most recent estimates for the period of 2011 to 2013.

From 2011 to 2013, the United States lost \$381 billion in revenue annually due to tax evasion and noncompliance

The Tax Gap report found that the United States lost an average of \$381 billion in unpaid taxes annually during that period. The average annual gross tax gap—the amount of taxes that taxpayers failed to pay voluntarily and on time—was \$441 billion. IRS enforcement actions and late payments brought in \$60 billion per year, resulting in a net tax gap of \$381 billion.

Needless to say, \$381 billion is a lot of revenue for the U.S. government to forgo every year. From 2011 to 2013, it was about one-seventh of “true” total tax liability; in other words, for every \$7 in taxes owed, about \$1 in taxes went unpaid, even after enforcement.¹¹

To put that in context, \$381 billion was more than half of what the federal government spent annually on national defense from 2011 to 2013. It was significantly more than what the government spent to provide health care for more than 50 million Americans through Medicaid.¹² And it was more than the United States spent on all mandatory income security programs—including nutrition assistance, Supplemental Security Income, unemployment compensation, family support and foster care, and refundable tax credits—combined.¹³

In terms of what the United States could have invested in but did not, \$381 billion is about six times what it would cost to provide universally affordable quality child care in the United States.¹⁴ It is about 19 times what it would have cost to end homelessness in America, according to one estimate.¹⁵ And it is more than twice what it would cost to rebuild America's infrastructure under House Democrats' new plan.¹⁶

Furthermore, the tax gap is likely even larger now. If compliance rates have held constant since the 2011–2013 period, the net revenue loss in 2019 would have been \$574 billion.¹⁷ And as discussed below, substantial cuts to IRS enforcement resources have also likely widened the tax gap.

The biggest portion of the tax gap is business owners underreporting their income

There are three forms of tax noncompliance: nonfiling, underreporting, and nonpayment. Underreporting is by far the biggest problem, responsible for 80 percent of the gross tax gap.

Components of the tax gap, 2011–2013¹⁸

Nonfiling refers to tax returns that are not filed on time and the tax owed on those returns that is not paid on time. It equaled \$39 billion in lost tax revenue.

Underreporting refers to tax returns that are filed on time but that understate the amount of tax owed. It equaled \$352 billion in lost tax revenue.

Underpayment refers to taxes that are reported on returns but that are not paid on time. It equaled \$50 billion in lost tax revenue.

The total gross tax gap, then, was \$441 billion.

Enforced and other late payments recouped \$60 billion in unpaid taxes.

The total net tax gap, then, was \$381 billion.

The largest single component of the tax gap is underreporting of business income on individual tax returns, which accounts for \$110 billion per year in lost revenue before enforcement. That type of income represents the profits of business entities such as partnerships, S-corporations, limited liability companies (LLCs), and sole proprietorships, which do not pay corporate income tax. Instead, their owners

report their share of the businesses' profits on their individual tax returns. In addition to the \$110 billion in income tax, owners of such businesses also failed to pay in a timely manner \$45 billion per year in self-employment tax.

Individuals underreported \$57 billion in tax on nonbusiness income as well. Misreporting of tax credits accounted for \$42 billion of the gross tax gap, and other types of income tax misreporting—such as exemptions and deductions—accounted for \$36 billion in lost tax revenue.¹⁹

The corporate income tax gap before enforcement was \$37 billion annually. As discussed below, however, this figure is likely an underestimate, and it does not reflect the larger problem of international corporate tax avoidance.

Virtually all wage income of workers is properly reported, but this is not the case for other forms of income

One of the most striking aspects of the Tax Gap report is the widely varying non-compliance rates for different types of income. Virtually all wage and salary income is properly reported; only 1 percent is not.²⁰ Wages are subject to both third-party information reporting and withholding. Employers are obligated to file information returns—W-2s—with the government reflecting the amount of wages paid to each employee and provide identical copies to employees. As a result, it is next to impossible for regular workers to misreport wage income without the IRS knowing about it. Wage income is also subject to withholding, meaning that employers set aside a portion of employees' paychecks for income and payroll taxes and remit it directly to the IRS on a quarterly basis. The IRS is said to have high "visibility" into the forms of income, such as wages, that have both third-party information reporting and withholding.

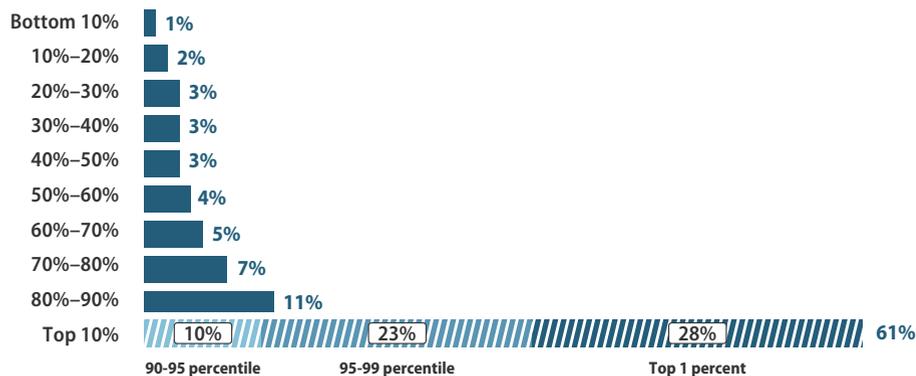
By contrast, there are much higher rates of noncompliance for forms of income into which the IRS has little visibility—usually business and capital income. Income from passthrough entities such as partnerships and S-corporations has a net misreporting percentage of 11 percent, not including payroll tax. Farm income and nonfarm business proprietor income have misreporting rates of 62 percent and 56 percent, respectively. Capital gains—received through the sale of assets such as stocks, business interests, and real estate—have a misreporting percentage of 23 percent.²¹

High-income taxpayers are primarily responsible for the tax gap

The Tax Gap report does not estimate the distribution of the tax gap—or how much tax noncompliance by low-, middle-, and high-income Americans costs the government. But researchers have derived such estimates from the IRS' findings. In 2010, tax economists Andrew Johns and Joel Slemrod found that the highest-income 10 percent of taxpayers are responsible for 61 percent of tax underreporting.²² More recently, Lawrence Summers, a distinguished senior fellow at the Center for American Progress and former secretary of the Treasury, and Natasha Sarin, assistant professor of law at the University of Pennsylvania and finance professor at the Wharton School, estimated that the highest-income taxpayers are responsible for an even greater share of the tax gap, with the top 1 percent responsible for roughly 70 percent of underreporting.²³

FIGURE 1
High-income taxpayers are responsible for most of the tax gap

Share of tax underreporting by income decile



Note: Johns and Slemrod's estimates are for tax year 2001. Estimates are of tax underreporting after refundable credits by estimated true adjusted gross income (AGI).

Source: Andrew Johns and Joel Slemrod, "The Distribution of Income Tax Noncompliance," *National Tax Journal* 63 (3) (2010): 397–418, available at <https://www.ntanet.org/NTJ/63/3/ntj-v63n03p397-418-distribution-income-tax-noncompliance.pdf?v=a&r=7181552540626139>.

One of the main reasons that high-income taxpayers account for such a large share of the tax gap is that they receive more income of the types that the IRS has difficulty monitoring.²⁴ The vast majority of low- and middle-income taxpayers' income derives from sources that have strong third-party information reporting, such as wages and Social Security benefits. But high-income taxpayers are much more likely to receive income that requires weaker information reporting and no withholding, such as partnership income or capital gains. High-income taxpayers also have the resources to hire professionals to create sophisticated tax avoidance or evasion schemes.²⁵

FIGURE 2A
Budget cuts have dramatically weakened IRS enforcement resources

IRS total budget in billions of 2018 dollars, 2010–2018

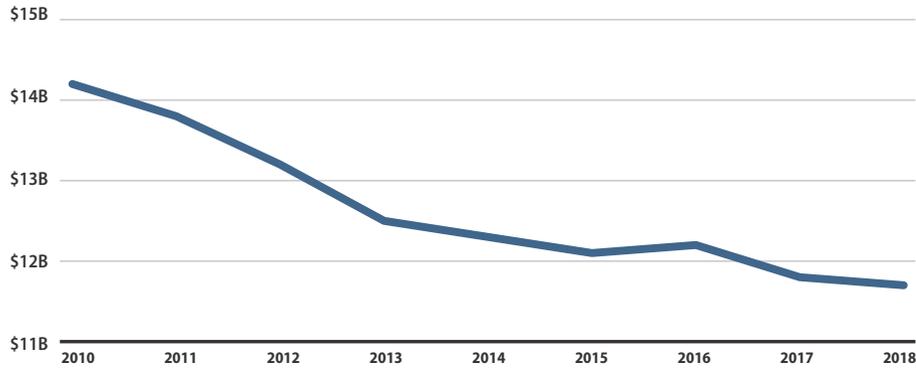


FIGURE 2B
IRS enforcement budget in billions of 2018 dollars, 2010–2018

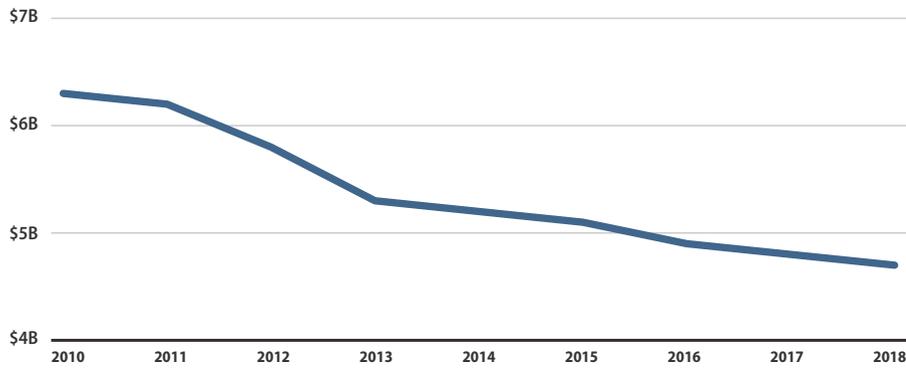
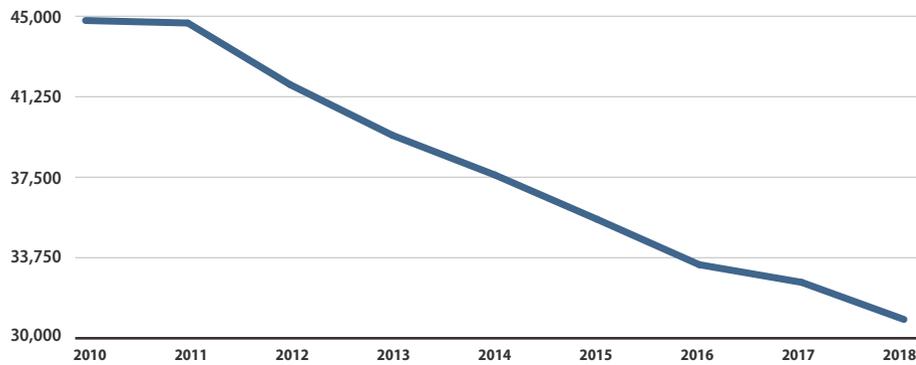


FIGURE 2C
Number of IRS examinations and collections personnel, 2010–2018



Source: Author's calculations based on Bureau of Labor Statistics Consumer Price Index for All Urban Consumers (CPI-U); IRS, "SOI Tax Stats - IRS Data Book Index of Tables," Table 28, Table 30, available at <https://www.irs.gov/statistics/soi-tax-stats-irs-data-book-index-of-tables> (last accessed February 2020).

The official tax gap estimates are only part of the story

The IRS' official tax gap estimates do not tell the entire story when it comes to tax evasion or the distinct but related issue of aggressive tax avoidance. In fact, the problem is much bigger, for at least several reasons:

- **Offshore tax evasion.** The IRS' tax gap estimates omit a large share of cross-border activity.²⁶ The tax gap theoretically includes unreported income from assets hidden offshore, but the audits that form the basis of the IRS' tax gap estimates rarely catch that type of evasion. Though the United States has taken several important steps over the past decade to combat offshore evasion, the problem undoubtedly persists. Researchers estimate that Americans hold \$1.2 trillion in offshore financial assets,²⁷ and while it is unknown how much of this wealth is undeclared, there is much anecdotal evidence that suggests Americans are continuing to hide assets offshore. Paul Manafort, for example, hid \$75 million in offshore accounts until he was caught.²⁸
- **“Legal” tax avoidance.** Because the tax gap is estimated as the difference between what taxpayers pay and what they lawfully owe, the revenue losses from lawful measures taken to avoid taxes are not included. Most tax avoidance behavior is perfectly legal and even intended—for example, when an individual contributes money to an individual retirement account to lower her tax bill and get the benefit of tax deferral. But since tax law is complex and ever evolving, there are large gray areas between legal tax avoidance and illegal tax evasion. An entire industry of accountants, lawyers, and other professionals advise wealthy individuals and businesses on these gray areas. Many of the murkiest areas involve valuation of assets or services. For example, the tax code requires owners of S-corporations who run the business or work for it to pay themselves “reasonable compensation.”²⁹ That rule is intended to ensure that these owners pay Social Security and Medicare taxes on the share of their income that derives from their labor. But they frequently lowball that number, paying themselves mostly in the form of profits that are not subject to Social Security or Medicare taxes.³⁰ In the unlikely event that the business owner is audited, the IRS may challenge whether the compensation is in fact “reasonable” and seek to adjust it—but in practice, the IRS is especially overmatched in such fact-intensive inquiries. Since the IRS' tax gap estimates are based on the results of audits, they exclude a great deal of aggressive tax-minimizing behavior that walks the fine line between avoidance and evasion.

- **Corporate profit shifting.** The biggest form of “legal” tax avoidance not included in the tax gap estimates is corporate profit shifting. Many global corporations structure their internal transactions to report as much of their profits in tax haven countries as they can get away with—and as little as possible in the United States. These corporate tax avoidance strategies are distinct from criminal tax evasion, but they exploit vast legal and factual gray areas. Corporations commonly locate intangible assets—such as copyrights or patents, which exist only on paper—in jurisdictions where they pay little or no tax on the profits generated from them.³¹ Economist and CAP Senior Fellow Kimberly Clausing estimates that the United States is losing about \$60 billion per year from corporate profit shifting.³²
- **Passthrough business noncompliance and the new loophole.** Passthrough businesses such as partnerships and S-corporations do not pay taxes on their profits. Instead, their profits “pass through” to their owners, who are required to report their share of the profits on their personal tax returns. But a recent study by Treasury Department and academic economists found that 30 percent of income reported on partnership tax returns—amounting to \$200 billion in 2011, the year studied—cannot be unambiguously matched with the ultimate owners who should be reporting the income. “Partnership ownership is not only concentrated [among high-income earners], but also opaque,” the authors found.³³ The Government Accountability Office (GAO) has found that audits of passthrough businesses have been ineffective at locating income.³⁴ Congress overhauled partnership audit procedures in 2015, which will hopefully improve enforcement. Unfortunately, the major federal tax legislation enacted in 2017 carved out a new 20 percent deduction for certain passthrough business income. Tax experts across the spectrum warned that creating such sharp and largely arbitrary distinctions in the treatment of income would open the door to new avoidance schemes—another gray area that will stretch the IRS’ enforcement and litigation resources.³⁵
- **Informal economy.** The tax gap estimates also do not include unreported income from informal, underground, and criminal activities that is especially difficult for the IRS to detect.³⁶
- **Time lag and methodological challenges.** The IRS’ latest tax gap report covers tax years 2011 to 2013, a time when IRS budget cuts were only beginning to take effect. Former IRS researcher Kim Bloomquist notes that the agency’s method in estimating the corporate tax gap fails to account for the recent “precipitous decline” in the number and thoroughness of audits of large corporations.³⁷ In fact,

the IRS' estimates of the corporate tax gap from 2011 to 2013 are based on the results of audits from several years earlier. Fewer and lighter audits may have swelled the corporate tax gap by the time of the 2011–2013 period, and corporate audit coverage has declined even further since then. Though Congress has given the IRS some additional enforcement tools, it seems very likely that the steep decline of audit coverage and the winnowing of IRS personnel have had a negative effect on tax compliance.³⁸

The IRS cannot adequately enforce the tax code given current resources and priorities

The magnitude of the tax gap is largely the result of policy choices. Congress has failed to give the IRS the resources and tools the agency needs to ensure better tax compliance. The IRS is auditing fewer taxpayers, with the steepest declines in audit coverage occurring for the tax returns of high-income individuals and corporations. When the IRS does examine taxpayers with substantial legal resources at their disposal, the agency is badly overmatched.

Congress made substantial cuts to the IRS' budgets over the past decade, at a time when the agency's responsibilities grew. IRS funding peaked in fiscal year 2010 at \$14.2 billion in 2018 dollars, but by fiscal year 2018, it had been cut by 17 percent in real terms.³⁹ Had the IRS' budget been held constant, adjusting for inflation, the agency would have received \$14 billion more in funding.⁴⁰

The enforcement functions of the IRS saw the steepest cuts in funding, with examinations and collections cut by 33 percent and investigations cut by 28 percent. These cuts hit at a time when the IRS' workforce was aging and many of its experienced personnel were retiring. From 2010 to 2018, the IRS lost 48 percent of its revenue officers, 41 percent of its tax technicians, and 35 percent of its revenue agents.⁴¹ All told, the IRS has lost about 14,000 of its enforcement employees since 2010—a drop from about 45,000 to 31,000.⁴²

FIGURE 3A
IRS audit rates for millionaires and large corporations have plummeted

Audit rate for millionaires, 2010–2018

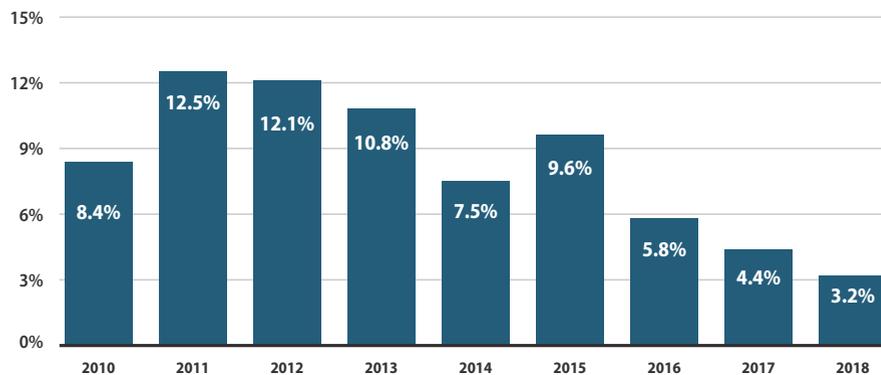
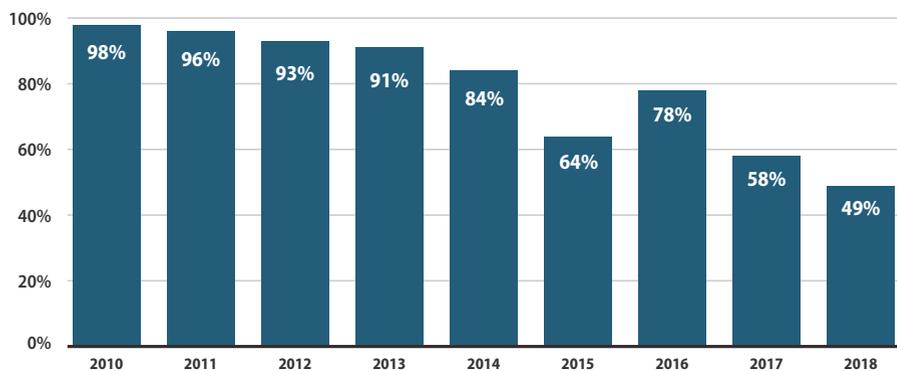


FIGURE 3B
Audit rate for largest corporations, 2010–2018



Note: Millionaires are individual taxpayers with \$1 million or more in total positive income. Largest corporations are those with \$20 billion or more in assets.

Source: IRS, "SOI Tax Stats - Examination Coverage: Recommended and Average Recommended Additional Tax After Examination - IRS Data Book Table 9a," available at <https://www.irs.gov/statistics/soi-tax-stats-examination-coverage-recommended-and-average-recommended-additional-tax-after-examination-irs-data-book-table-9a> (last accessed February 2020).

Not surprisingly, the IRS is doing less with less: Audit rates have plummeted, especially for corporations and high-income individuals. The total audit rate for individuals has dropped from 1.1 percent in 2010 to 0.6 percent in 2019.⁴³

Audit rates for millionaires have dropped by more than half in just the past three years, to the point where 97 out of every 100 millionaires are not audited.⁴⁴ A decade ago, nearly all very large corporations were audited; now, fewer than half are.⁴⁵ Corporate audits brought in \$12 billion less in FY 2018 than in FY 2010.⁴⁶ Given resource constraints, the IRS division responsible for auditing large corporations

has said it is shifting its focus from examining a corporation's entire return to zeroing in on specific issues. And the Treasury Inspector General for Tax Administration (TIGTA) reported last year that the IRS is not selecting or prioritizing issues based on past compliance results or potential impact on compliance.⁴⁷ The IRS has also become more willing to compromise with corporations during audits and accept small adjustments rather than pursue cases through appeals and litigation.⁴⁸

IRS budget cuts have benefited criminal tax cheats. Due to budget cuts and attrition in the ranks of special agents—the specially trained “cops” on the tax beat—the IRS is initiating fewer criminal investigations and referring fewer cases to the Department of Justice for prosecution.⁴⁹ The IRS has nearly one-third fewer investigations personnel than it did a decade ago.⁵⁰ In FY 2012, the IRS initiated 5,125 criminal investigations; in FY 2018, the number dropped to 2,886—a 44 percent reduction. The IRS referred 680 tax fraud cases for prosecution in 2018, down from 1,401 in 2012.⁵¹ A former IRS criminal enforcement officer told ProPublica, “Due to budget cuts, attrition and a shift in focus, there’s been a collapse in the commitment to take on tax fraud.”⁵²

The IRS is even failing to pursue high-income people who completely fail to file tax returns. TIGTA found that the IRS has failed to pursue 369,176—or 42 percent of—high-income nonfilers in tax years 2014 to 2016, who owe a collective \$16 billion. The remaining 510,239 high-income nonfilers and the \$29 billion they owe are in the IRS’ collection inventory, “but generally will not be pursued due to decreased Collection resources.”⁵³ The IRS is also sending out fewer notices to taxpayers who have information on their tax returns that does not match information the IRS has received from information returns such as W-2s and 1099s.⁵⁴

Funding issues have also helped set back the IRS’ efforts to crack down on offshore tax evasion. In 2010, Congress enacted the Foreign Account Tax Compliance Act (FATCA), which imposed new requirements on foreign financial institutions in an effort to prevent them from hiding assets of their American accountholders. Pursuant to FATCA, the U.S. Treasury Department struck cooperation agreements with 113 countries. However, recent reports by government watchdogs have found that the IRS has taken few of the steps needed to implement the law.⁵⁵

Though Congress has provided some modest funding increases for the IRS in the past two years,⁵⁶ the agency’s problems could get worse before they get better, as the IRS may lose some of its most experienced personnel with no ready way to replace them. According to the IRS commissioner, nearly half of the IRS’ workforce is eli-

gible to retire over the next two years, and less than 3 percent of the IRS workforce is under age 30.⁵⁷

The agency's brain drain will leave it ill-equipped to enforce the law. In particular, at current funding and personnel levels, the IRS is nowhere near capable of sufficiently tackling the complex issues that arise in the tax affairs of corporations and very wealthy individuals. In testimony to Congress earlier this year, former IRS attorney Kenneth Wood described the mismatch between large corporations and the IRS when it comes to audits of corporate transfer pricing.⁵⁸ Transfer pricing is critically important for tax collection because it determines how much of the total profits of global corporations are reported in the United States and how much are reported in other countries, including tax havens. During his testimony, Wood explained:

The facts of each transaction are, typically, very complex, the economic analysis is difficult and not susceptible of precision, and the legal guidelines are somewhat blunt. In short, the task of auditing the pricing of trillions of dollars of transactions, within the statute of limitations, is an extraordinarily heavy lift. And as budgets shrink and senior personnel with substantial transfer pricing experience retire and cannot be replaced, transfer pricing audits become more and more challenging, and tax revenues fall. ...

On the other side of the equation are large, well advised multinational corporations that control the facts but resist responding to legitimate IRS inquiries in a timely manner in the hope that they can run out the clock before the IRS has fully developed it's case. Given the tax dollars at risk, these taxpayers spend tens of millions of dollars annually on tax litigation. If you are curious, I suggest you review the financial statements of taxpayers that have recently litigated, or are litigating, a large transfer pricing case. These expenditures support not just a substantive defense of their tax position but also efforts to undermine the IRS's ability to develop it's case. It is hard-ball litigation by counsel zealously representing their clients, and they have far larger budgets than the IRS. Taxpayers are understandably willing to spend millions to save billions. While the IRS has excellent, very hard working litigators, the organization has far fewer resources than taxpayers to devote to these cases.

The resources available to government auditors and litigators will never match those of very wealthy individuals or large corporations, who have white-shoe law firms, Big Four accounting firms, and other resources on their side. But in recent years, the disparity in resources has grown significantly. ProPublica recently reported on how IRS auditors struggled for years to obtain documents and piece apart the byzantine

transactions that Facebook used to, in its own words, “park profits” in offshore tax havens, with the agency running into resource limitations.⁵⁹ A recent study found that had the IRS’ enforcement budget been about \$1 billion larger annually, it would have collected an additional \$34 billion in revenue from large corporations from 2002 to 2014, reducing the estimated corporate tax gap by nearly 20 percent, in addition to additional revenue from individuals and other businesses.⁶⁰

In short, by starving the IRS of the resources to do its job, the United States is transferring tax revenue to the people—primarily high-income individuals—who are evading or aggressively avoiding taxes.

IRS audit priorities are badly out of balance

While resource constraints are the IRS’ biggest challenge, the agency has also focused its resources poorly, disproportionately targeting low-income workers. The IRS’ enforcement efforts are targeted especially at tax returns claiming the earned income tax credit (EITC), a tax credit for low-income workers that supplements wages.

The EITC accounts for only a small part of the overall tax gap. In fact, misreporting of all tax credits accounted for less than 10 percent of the gross tax gap from 2011 to 2013.⁶¹ Congress has also taken several steps intended to reduce EITC and Child Tax Credit noncompliance in the past several years that were not in effect during the period analyzed in the Tax Gap report.⁶²

In 2017, 18 percent of all individual taxpayers claimed the EITC, yet EITC claimants were 43 percent of those who were audited.⁶³ EITC recipients are twice as likely to be audited than other taxpayers.⁶⁴ As ProPublica found, because audit rates for high-income individuals have declined so rapidly in recent years, the IRS now audits EITC recipients at the same rate as the top 1 percent of taxpayers.⁶⁵

The IRS’ disproportionate focus on EITC recipients is inequitable along several dimensions. The IRS currently audits people much more heavily in high-poverty areas of the country.⁶⁶ The five counties with the highest audit rates are predominantly African American rural counties in the South.⁶⁷ The disproportionate focus on EITC recipients in audits comes on top of special restrictions for claiming the credit that do not apply to most other tax benefits.⁶⁸

The manner of EITC audits is also problematic. Most EITC audits are conducted by correspondence: The IRS sends letters to taxpayers stating that they are being audited and requesting that they substantiate their EITC claims within 30 days. Because of the lack of personal contact, correspondence audits are cheap for the IRS to conduct but very difficult for taxpayers to navigate.⁶⁹ The IRS' National Taxpayer Advocate has reported to Congress that correspondence audits are one of the agency's "most serious problems." The correspondence audits confuse and intimidate taxpayers, often failing to provide them sufficient time to respond or a point of contact to whom to speak.⁷⁰ The vast majority of EITC recipients do not have a professional representing them, and many face language barriers.⁷¹

Researchers analyzing a sample of EITC correspondence audits found that the vast majority resulted in credits being denied due to nonresponse or insufficient response from the taxpayer, which could indicate either that the EITC claim was invalid or simply that the taxpayer was ill-equipped to respond in time. Only 15 percent of audits were able to confirm ineligibility for the credit; in 40 percent of cases where the credit claim was denied but taxpayers later received assistance from the Taxpayer Advocate Service, the IRS' decision was reversed.⁷² Correspondence audits also do not improve the tax filers' understanding of the rules going forward, and research suggests that many who are in fact eligible for the EITC are deterred from claiming it—and potentially even from working—in the years following a correspondence audit.⁷³ The IRS' focus is on conducting and closing the audits as quickly as possible, not on whether the audits help taxpayers understand the law better or improve their future compliance.⁷⁴

In April 2019, Sen. Ron Wyden (OR), the top-ranking Democrat on the Senate Finance Committee, demanded that the IRS develop a plan to reprioritize its audit resources.⁷⁵ However, Internal Revenue Commissioner Charles Rettig responded by laying the blame on Congress for not providing enough funding to audit more higher-income taxpayers. According to Rettig, "The IRS cannot simply shift examination resources from single issue correspondence audits to more complex higher income audits because of employee experience and skillset."⁷⁶ The typical tax examiner conducting correspondence audits, Rettig wrote, "is not trained to conduct a high income, high wealth taxpayer audit." In other words, given current IRS resources, the IRS can send letters to low-income taxpayers demanding additional substantiation but cannot audit more wealthy people.

Commissioner Rettig asserts that EITC correspondence audits are “the most efficient use of available IRS examination resources.” That assertion is questionable. TIGTA has noted, for example, that audits of taxpayers with incomes above \$5 million produced an average of \$4,545 in tax adjustments per hour of revenue agents’ time and recommended that the IRS reallocate resources to focus on high-income tax returns.

The IRS’ disproportionate focus on EITC claims raises fundamental equity concerns. One of the reasons it is so cheap for the IRS to audit EITC recipients—and why the IRS recoups so many credits when taxpayers fail to respond or respond sufficiently—is that low-income taxpayers do not have the means to hire representation to defend them in audits. While wealthy and corporate taxpayers who find themselves audited have significantly more resources than the IRS, the imbalance of resources is the extreme opposite for low-income taxpayers.

Commissioner Rettig is not wrong in emphasizing that the IRS currently lacks the resources to audit higher-income taxpayers thoroughly and effectively. But the disproportionate targeting of EITC claimants for audit, and the experience of the audits, is corrosive to overall taxpayer morale, sending the signal that the law is not being enforced fairly or evenly.

In sum, the official “tax gap” and the related problem of aggressive tax avoidance drain the U.S. government of hundreds of billions of dollars of needed revenue every year. The failures of tax enforcement increase inequality both directly—because high-income and corporate taxpayers are mainly responsible for the revenue shortfall—and indirectly—because the revenue could be invested in ways that enhance broad-based prosperity. The IRS does not have the resources to adequately enforce the tax laws, with the problem getting significantly worse over the past decade. And the IRS’ audit priorities are out of balance. Policymakers intent on addressing overall economic inequities must address how U.S. tax laws are enforced.

Strategies to improve tax enforcement

Policymakers have several ways to improve tax enforcement, including providing the IRS additional resources, better allocating those resources, and giving the IRS additional visibility into transactions.

Invest in IRS tax enforcement

Congress should make a substantial, multiyear investment in tax enforcement so that the IRS can make long-term plans to bolster its human and technological resources. After years of substantial real cuts to the IRS budget, the agency has seen a very modest funding increase. In the FY 2020 budget, the total IRS budget was increased by 1.8 percent and the enforcement budget was increased by 3.1 percent—essentially flat, given inflation and cost-of-living adjustments for federal workers.⁷⁷ Much more is needed to rebuild and further strengthen the IRS’ enforcement function.

Two areas of investment are particularly important: hiring more, and more highly skilled, enforcement personnel and investing in technology.

The IRS has ground to make up in rebuilding its workforce. The agency lost opportunities to bring in younger personnel because of a hiring freeze in effect from 2011 to 2018.⁷⁸ And with 45 percent of IRS personnel eligible for retirement over the next two years, the IRS faces a crisis. “Highly trained and experienced revenue agents who work the most complex audits take many years to replace,” explains GAO auditor James McTigue.⁷⁹ It takes at least three years to equip new personnel to handle complex returns, such as those for business owners, according to the Tax Policy Center’s Janet Holtzblatt.⁸⁰

Incremental funding increases through annual appropriations will not be enough. Congress must provide a major, multiyear funding increase to enable the IRS to rebuild its workforce. Top priority should be given to onboarding and training enforcement personnel who will be equipped to examine complex individual, cor-

porate, partnership, and estate tax returns. Such an investment would more than pay for itself. Natasha Sarin and Lawrence Summers note that the average IRS employee makes roughly \$55 per hour. And according to the IRS, revenue agents auditing multimillionaires return approximately \$4,900 in tax adjustments per hour.⁸¹

Given the increasing importance of technology, many of the next generation of IRS agents will need new skills. IRS Criminal Investigation Division Chief Don Fort said, “We need agents that have cyber background; we need agents that are stronger in computer fields. We need investigative analysts that have these skills; we need data scientists.”⁸²

In addition, Congress must invest in the IRS’ technological resources. The IRS’ information technology (IT) is notoriously antiquated. The core systems that hold taxpayer records were state of the art 60 years ago,⁸³ but now they are the oldest in the federal government.⁸⁴ Yet the IRS’ many systems are layered on top of this dinosaur technology, limiting efficiency, imposing legacy costs, and threatening to crash.⁸⁵ As the IRS’ programmers retire, the agency is struggling to find new personnel who know the archaic programming language.⁸⁶ The IRS’ IT systems diminish the quality of taxpayer service in numerous ways.⁸⁷ Yet the IRS’ IT budget is 25 percent less in real terms than it was in 1993.⁸⁸ Former Internal Revenue Commissioner Charles Rossotti notes that four of the largest U.S. banks invest nearly \$10 billion in technology, on average—four times as much as the IRS spends, even though each of the banks maintains records on at most one-quarter as many individuals and businesses as the IRS does.⁸⁹

Improvements in information technology can equip the IRS to better enforce the tax laws. Advanced data analytics is becoming an increasingly important component of tax enforcement, but to use those tools effectively and securely, the IRS will need modern technology.⁹⁰ The IRS has implemented what it calls a Return Review Program (RRP), which uses analytics to help detect potentially fraudulent tax returns claiming refunds and to intercept those refunds before they are paid out. However, the IRS has not sought to use the RRP’s capabilities to detect potential misreporting on tax returns not claiming refunds or to help select returns for audits or other types of compliance efforts. In the view of the Government Accountability Office, by failing to apply RRP to returns not claiming refunds, the IRS may be missing opportunities to catch fraud and noncompliance more efficiently and make progress toward closing the tax gap.⁹¹

In April 2019, the IRS announced a six-year strategy to modernize its IT systems, with a total estimated cost of \$2.3 billion to \$2.7 billion.⁹² To put that amount in perspective, Rossotti notes that the four largest banks spend \$3 billion to \$5 billion annually on technology improvements.⁹³ Congress, however, appropriated only \$180 million for the current fiscal year for systems modernization—two-thirds of what the IRS requested—underscoring the agency’s challenge in relying on annual appropriations to make major, multiyear investments.⁹⁴ The IRS will not be able to make the sustained investments needed to overhaul its IT systems without robust, multiyear funding.⁹⁵

Change budget scorekeeping rules to more accurately account for better tax enforcement

One reason that the IRS has struggled to find adequate funding is that proposals to increase tax enforcement are disadvantaged in the legislative process, largely due to how they are scored. Under current practice, if Congress considers legislation to increase funding for tax enforcement, it would score as increasing deficits—even though there is abundant evidence that every additional dollar spent on tax enforcement returns at least several dollars in revenue.

This shortsighted practice stems from the “Scorekeeping Guidelines” agreed upon by the House and Senate Budget Committees, the Congressional Budget Office (CBO), and the Office of Management and Budget, which prevent the scorekeepers from taking into account any secondary effects of increases in funding for administering federal programs.⁹⁶ As a result, the direct costs of increased IRS enforcement are reflected in budget scores, but the additional revenue that will be collected is intentionally omitted.⁹⁷ Thus, investments in tax enforcement are scored as increasing deficits when in fact they do the opposite.⁹⁸

Legislation that increases deficits is vulnerable to various procedural hurdles in Congress, including pay-as-you-go, or PAYGO, points of order, as well as the PAYGO law that forces spending cuts if Congress passes legislation during a year that is scored in total as increasing deficits. And as a practical matter, Congress cannot use investments in tax enforcement to offset the budgetary costs of other legislation.

However, the scorekeeping guidelines are only that: guidelines. Congress can, and should, change how the guidelines are applied in scoring investments in tax enforcement. In a related context, policymakers have recognized that investments in tax

enforcement have manifold returns. Both the Obama and Trump administrations called for special adjustments to the caps on annual discretionary spending to create modest additional headroom for IRS enforcement funding.⁹⁹

Second, while the CBO has provided nonscoreable estimates of the revenue feedback from additional funding for tax enforcement, those estimates likely vastly underestimate the return on investment from a more comprehensive approach to improving tax compliance. In the menu of “Budget Options” that the CBO publishes periodically, the office estimated that increasing IRS enforcement resources by \$20 billion over the next 10 years would increase revenue by \$55 billion, for a net return for the government of \$35 billion.¹⁰⁰ But those estimates only reflect revenue gained directly from enforcement actions such as audits. The CBO did not attempt to estimate the indirect effects—that is, “the extent to which taxpayers would respond to new enforcement initiatives by becoming more compliant with the tax code.”¹⁰¹ Tax enforcement actions make taxpayers more compliant themselves, and can have indirect ripple effects where other taxpayers become more compliant as well.

And yet those effects, while difficult to estimate, are very likely to be much bigger than the direct effects. The Treasury Department has estimated that the direct revenue effect of new investments in enforcement would be \$6 for every \$1 invested—and that the indirect effects from “deterrence” would be at least three times as large—implying a total return on investment, counting direct and indirect effects, of \$24 for every \$1 invested.¹⁰² IRS economist Alan Plumley has found that the indirect revenue effects of audits are 12 times as large as the direct effects.¹⁰³ He finds that an additional \$1 spent on audits returns \$55 in indirect revenue, while every \$1 spent on obtaining criminal convictions results in \$16 in indirect revenue.¹⁰⁴ Another study estimates that each new dollar invested in civil audits results in \$58 in additional revenue by deterring noncompliance, and each new dollar invested in criminal investigation produces \$66.¹⁰⁵ Sarin and Summers estimate that the United States could gain more than \$1 trillion in revenue from a comprehensive approach to improving tax enforcement.¹⁰⁶

The CBO Budget Option is also very limited in that it simply seeks to estimate the effect of increased enforcement resources without complementary policies. The CBO acknowledged:

Combining an increase in funding with legislation that expanded enforcement mechanisms (such as enabling the IRS to obtain more information that could be used to verify taxpayers' claims or imposing higher penalties) would probably be a more effective approach to significantly increase compliance and reduce the budget deficit.¹⁰⁷

In sum, a more comprehensive approach that gives the IRS more resources and better enforcement tools would produce much greater returns on investment—especially when incorporating the difficult-to-estimate but potentially enormous indirect revenue effects.

Tax enforcement produces revenue directly and indirectly

Direct effect: Audits and other tax enforcement actions directly result in additional taxes, interest, and penalties collected by the government.

Indirect effect: Civil and criminal tax enforcement also produces revenue indirectly by inducing better compliance. There are “subsequent year effects,” where taxpayers who have been audited or otherwise been the subject of tax enforcement change their future compliance behavior.¹⁰⁸ There are also more indirect “ripple effects,” where enforcement actions have a broader deterrent effect on the population at large.¹⁰⁹

Reprioritize IRS enforcement resources and rebuild the ‘wealth squad’

New investments in the IRS must be directed to where the problem exists: the high-income and corporate taxpayers who are responsible for the lion’s share of revenue lost from weak enforcement. Currently, the IRS’ enforcement priorities are upside down, focusing disproportionately on EITC recipients. While providing additional, multiyear funding, Congress should require the IRS, as a first step, to develop a plan to restore audit rates for high-income and corporate taxpayers to 2011 levels. In 2011, 1 in 8 millionaires were audited, compared with about 1 in 30 in 2018. In 2011, nearly all of the largest corporations were audited, compared with less than half in 2018.¹¹⁰

Part of that congressional investment should be directed toward rebuilding the IRS’ “wealth squad,” so that the IRS has the experienced personnel needed to audit high-income taxpayers and the entities that they own, including passthrough businesses and trusts. The agency tried to stand up such a group several years ago, but Congress never provided the necessary resources. On the contrary, Congress began slashing the IRS’ budget soon after the wealth squad was launched.¹¹¹ Lawyers for the wealthy taxpayers subjected to audits lobbied IRS leadership and Congress to ease up. As a result, the group’s audits were not nearly as comprehensive as originally envisioned. The wealth squad has since been “deemphasized organizationally” and folded into another IRS division.¹¹² That decision should be reversed.

For years, the Treasury Inspector General for Tax Administration has also emphasized that the IRS has spread its resources too thin when auditing high-income taxpayers. The IRS has defined “high income” as beginning at \$200,000, and focused nearly half of its high-income audits on taxpayers earning between \$200,000 and \$399,999—despite the fact that taxpayers in that affluent group are more likely to be wage earners whose income is visible to the IRS and therefore “low risk.”¹¹³ Revenue agents auditing taxpayers with more than \$5 million of income returned \$4,545 of audit adjustments per hour—7.5 times more than the return on audits of the \$200,000–\$399,999 group. TIGTA has repeatedly called on the IRS to increase the high-income threshold, but the IRS has not done so.¹¹⁴

The IRS should also heed the National Taxpayer Advocate’s recommendations on correspondence audits, which include ensuring that taxpayers receive at least one personal contact and assigning a single point of contact for taxpayers.¹¹⁵ Making correspondence audits easier to navigate for taxpayers is likely to improve future compliance, as taxpayers come to better understand the rules governing tax provisions such as the EITC and their own filing responsibilities.

Expand the scope of information reporting and withholding

The Tax Gap report makes clear that a critical factor in the IRS' ability to collect taxes on various forms of income is whether it has visibility into that income through third-party information reporting and withholding.

FIGURE 4 Compliance rates depend on "visibility" of income

Net misreporting percentage by type of income, 2011–2013

Income subject to substantial information reporting and withholding:

wages, salaries

1%

Income subject to substantial information reporting:

pensions, annuities, unemployment compensation, dividends, interest, Social Security benefits

5%

Income subject to some information reporting:

partnership and S corporation income, capital gains, alimony

17%

Income subject to little or no information reporting:

proprietor income, rents and royalties, farm income, other income, sales of business property

55%

Source: Barry W. Johnson and others, "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013" (Washington: IRS, 2019), Figure 3, available at <https://www.irs.gov/pub/irs-pdf/p1415.pdf>.

The largest area where greater information reporting is needed is payments to and between businesses. According to IRS research, “[T]he lack of reliable and comprehensive reporting and withholding for business income received by individuals is the main reason [that underreporting of business income is the largest component of the tax gap]. . . . Business income reported on Form 1040s is a much lower-visibility income source because it is not often subject to the same information reporting and withholding requirements that exist for salary and wage income.”¹¹⁶

A number of changes have been proposed to improve information reporting for business income:

- **Require bank information reporting.** To enhance visibility into business income, former IRS Commissioner Rossotti recently proposed requiring business owners and entities with more than a certain amount of income to designate the bank accounts that they use to receive business income. Banks, in turn, would issue information returns to the business owners and to the IRS—in much the same manner that employers report wages on W-2 forms to employees and the IRS—with a summary report of deposits received and disbursements. Taxpayers would reconcile the amounts reported by the bank with the amounts reported on their tax return. Rossotti estimates that the proposal would generate about \$170 billion in revenue each year from both improved enforcement capabilities and better voluntary compliance. President George W. Bush’s tax reform commission made a similar proposal in 2005.¹¹⁷
- **Require corporations and partnerships to file tax returns electronically.** Universal use of electronic filing enables the IRS to analyze data on tax returns for potential mismatches with other information or other indicators of tax noncompliance. The GAO has recommended that all corporations and partnerships be required to file their tax returns electronically to “help IRS reduce return processing costs, select the most productive tax returns to examine, and examine fewer compliant taxpayers.”¹¹⁸
- **Requiring contractors providing services to businesses to provide taxpayer identification numbers (TINs).** The Obama administration proposed requiring that a contractor receiving more than \$600 in payments in a year from a particular business provide that business with the contractor’s TIN—and if no TIN is provided, requiring the business to withhold taxes on the payments. Having the TIN allows the business making payments to file information returns reporting payments to the IRS.
- **Third-party settlement organizations (TPSOs):** With a traditional employer-employee relationship, the employer withholds taxes from the employee’s paychecks, files quarterly employment tax returns, and gives both the government and the employee an annual W-2 information return stating how much the employee earned in the prior year. However, major gig economy platforms characterize themselves as online payment platforms—technically, TPSOs—not as employers.¹¹⁹ Under Treasury Department regulations, TPSOs are not required to give payees information

returns unless the payee has at least 200 transactions or \$20,000 in payments on the platform; this results in a large amount of income not visible to the IRS.¹²⁰ These thresholds should be lowered.

- **1099 reporting.** In 2010, Congress strengthened two reporting requirements: Businesses would have been required to file Form 1099s for all payments to payees such as vendors if they exceeded \$600 per year, and individuals receiving rental income—more than half of whom misreported their income, according to a GAO study—would have been required to issue 1099s for payments of \$600 or more.¹²¹ Unfortunately, Congress reversed course and repealed these requirements a year later.¹²² Given the persistence of the tax gap for business taxpayers, Congress should reconsider those measures.

Better information reporting gives the IRS better visibility into more forms of income. It is also critical that the IRS make better use of the information it receives. In 2017, the GAO reported that the IRS does not automatically match the information return filed by partnerships and S-corporations—Form K-1—to the income information on tax returns filed by partners who are themselves partnerships or S-corporations.¹²³ It should do so.

Improve employment tax enforcement

In some areas, the IRS is also failing to do basic due diligence and is therefore failing to collect low-hanging revenue. TIGTA reported that the IRS did not follow up on 83 percent of cases where employers reported to the Social Security Administration on W-2 forms that they had withheld tax from employees but did not fully report those withholdings on the business employment tax returns.¹²⁴ These are instances where the IRS knows that tax is not being properly paid, totaling \$7 billion in potentially underreported tax. In selecting which cases to work, the IRS was not prioritizing those with the biggest amounts of revenue at stake. TIGTA has also found that the IRS is failing to collect several billions of dollars by failing to use its authority to assess tax automatically against businesses that fail to file employment tax returns.¹²⁵

Better regulate tax preparers and expand VITA programs

While many tax preparers are credentialed as certified public accountants (CPAs), attorneys, or enrolled agents, most are not.¹²⁶ And there are currently no competency standards for paid tax preparers. Alarming, tax returns prepared by preparers have more errors than self-prepared returns, as well as larger adjustments when taxpayers are audited.¹²⁷ In 2018, then-Taxpayer Advocate Nina Olson warned Congress, “If anyone can hang out a shingle as a ‘tax return preparer’ with no minimum competency requirements or oversight, problems with return accuracy will abound.”¹²⁸

Several years ago, the IRS moved to require paid tax preparers to register with the IRS and meet minimum competency standards. But federal courts ruled that the IRS lacked the statutory authority.¹²⁹ Congress has considered legislation to overturn the court decision and provide the IRS with the authority to regulate paid preparers but has not yet acted.¹³⁰ Congress should give the IRS this commonsense authority. And in the meantime, the IRS should use its existing authorities to take a more aggressive stance against unscrupulous preparers, including imposing penalties with more regularity.

Research also suggests that low-income taxpayers’ returns that are prepared by volunteers at Volunteer Income Tax Assistance (VITA) sites have high rates of compliance. This suggests that greater public and private funding for VITA programs would help improve tax compliance at the same time as it reduces low-income taxpayers’ reliance on costly paid services.

Improve tax gap estimates and their presentation

Integrate the tax gap into the improper payments processes

Every tax dollar that goes unpaid has the same effect on the federal Treasury as a dollar that is misspent by a government program. Yet the tax gap tends to receive less regular attention from policymakers and the media than the problem of erroneous payments by government programs, or so-called improper payments. This is despite the fact that the U.S. budget is affected far more by tax noncompliance than by improper payments. In FY 2018, agencies reported improper payment estimates totaling \$151 billion, or 4.6 percent of total spending for the estimated programs—compared with the 2011–2013 net tax gap of \$381 billion per year, which was 14 percent of true tax liability over that period.¹³¹

Part of the reason that improper payments receive more attention than the tax gap is that there exists a statutory regime to track and publicize them and to force federal agencies to address them. In 2002, Congress enacted the Improper Payments Information Act, requiring agencies to identify programs susceptible to improper payments and estimate the amount of such payments annually. Agencies have since been required to identify so-called high-priority programs, establish annual targets and develop plans for reducing improper payments in those programs, and improve risk assessment and other practices.¹³² Today, agencies report improper payments on more than 160 programs, with 20 identified as being high priority. Only one program is part of the tax code: the EITC.

Erroneous EITC refunds are counted as improper payments because they are technically government outlays. But no other kind of tax noncompliance is subject to the improper payments reporting regime, even though many kinds of noncompliance by tax filers—individual or corporate—result in improper tax refunds as well. Former Taxpayer Advocate Nina Olson has said that she believes that the inclusion of the EITC within the improper payments priority list is one reason why the IRS has focused its enforcement resources disproportionately on the EITC.¹³³

To make the improper payments framework more meaningful, Congress and the Treasury Department should strive to integrate tax revenue losses. Though it takes the National Research Program years to develop the IRS' Tax Gap report, its estimates of the sources of unpaid taxes and noncompliance rates should be presented alongside federal agencies' estimates of improper payments. The IRS' NRP should provide more information about the tax gap resulting from specific types of income and specific tax provisions.¹³⁴ And the Treasury Department should be required to report annually on major areas of tax noncompliance in its agency improper payments report. Areas of the tax code that have high revenue losses, such as corporate transfer pricing or income reporting of passthrough businesses, should be identified as high-priority areas that require plans to address.

Publish distribution of the tax gap

The IRS or the Treasury Department's Office of Tax Analysis should also publish estimates of the distributional effects of tax noncompliance. Given that the IRS already estimates underreporting of various forms of income, it is feasible to estimate the amount of revenue lost by income group, as the Johns-Slemrod analysis did.¹³⁵ Such distributional estimates are important in allowing Congress and the

public to understand who is not paying the taxes they owe. Given that the bulk of tax noncompliance is from high-income people, having these estimates will likely increase support for better enforcement. It can only improve Congress' decision-making.

Study the offshore tax gap

As mentioned above, the tax gap research project does not adequately seek to estimate the scope of the offshore tax gap, or the amount of revenue lost from Americans hiding assets offshore. From its very nature, offshore evasion is difficult to detect, but the Foreign Account Tax Compliance Act of 2010 will continue to give the IRS more information about offshore activity.¹³⁶ Congress should require the IRS to study the offshore tax gap to gauge the scale of the problem.

Conclusion

Improving the enforcement of America’s tax laws can generate much-needed federal revenue. Since high-income taxpayers are primarily responsible for the tax gap, ensuring that the wealthy pay the taxes that they owe will reduce income inequality. Curbing tax evasion and aggressive tax avoidance creates a level playing field for honest taxpayers, including regular workers who have no choice but to comply with the tax laws because taxes are withheld automatically from their paychecks and because their pay is reported on the W-2s that employers file with the government.

The final element needed to substantially improve tax enforcement in the United States is political will. Past attempts to bolster tax enforcement have fallen victim to political resistance. Congress has shortchanged the IRS’ budget, reversed its own pro-enforcement initiatives, and even pressured the IRS to ease up on audits of wealthy people.¹³⁷ But there is increasing recognition that the weakening of tax enforcement is draining needed revenue—and that it is another contributing factor behind the inequality that weakens the United States’ economy and democracy. Unrigging the economy, and laying the groundwork for more inclusive prosperity, requires enforcing the tax laws fairly and adequately.

About the author

Seth Hanlon is a senior fellow at the Center for American Progress.

Acknowledgments

The author thanks Sara Estep, Galen Hendricks, Divya Vijay, Curtis Nguyen, and Colin Medwick for their research assistance and input, and the many colleagues who have shared ideas and substantive feedback.

Endnotes

- 1 *United States of America v. Paul J. Manafort Jr. and Richard W. Gates III*, Crim. No. 1:18 Cr. 83, para. 1–7, available at <https://www.justice.gov/file/1038391/download>.
- 2 Franklin Foer, “Paul Manafort, American Hustler,” *The Atlantic*, March 2018, available at <https://www.theatlantic.com/magazine/archive/2018/03/paul-manafort-american-hustler/550925/>.
- 3 Jesse Eisinger and Paul Kiel, “The IRS Tried to Take on the Ultrawealthy. It Didn’t Go Well,” *ProPublica*, April 5, 2019, available at <https://www.propublica.org/article/ultrawealthy-taxes-irs-internal-revenue-service-global-high-wealth-audits>.
- 4 Zachary Milder, “RenTech’s Billion-Dollar Tax Cloud Darkens After IRS Ruling,” *Bloomberg*, November 13, 2019, available at <https://www.bloomberg.com/news/articles/2019-11-13/irs-decision-is-bad-omen-for-rentech-tax-dispute-worth-billions?sref=S5RPFKR>.
- 5 David Barstow, Susanne Craig, and Russ Buettner, “Trump Engaged in Suspect Tax Schemes as He Reaped Riches From His Father,” *The New York Times*, October 2, 2018, available at <https://www.nytimes.com/interactive/2018/10/02/us/politics/donald-trump-tax-schemes-fred-trump.html>.
- 6 Paul Kiel, “Who’s Afraid of the IRS? Not Facebook,” *ProPublica*, January 23, 2020, available at <https://www.propublica.org/article/whos-afraid-of-the-irs-not-facebook>.
- 7 Vanessa Williamson, “Americans Love Paying Taxes,” *The Atlantic*, April 15, 2015, available at <https://www.theatlantic.com/politics/archive/2015/04/americans-love-paying-taxes/390582/>.
- 8 National Taxpayer Advocate, “2011 Annual Report to Congress, Volume One” (Washington: Internal Revenue Service, 2011), p. 14, available at https://www.irs.gov/pub/tas/irs_tas_arc_2011_vol_1.pdf.
- 9 The World Bank and Organization for Economic Cooperation and Development, “Improving Co-Operation between Tax Authorities and Anti-Corruption Authorities in Combating Tax Crime and Corruption” (Paris and Washington: 2018), available at <https://www.oecd.org/tax/crime/improving-co-operation-between-tax-authorities-and-anti-corruption-authorities-in-combating-tax-crime-and-corruption.pdf>.
- 10 IRS, “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013” (Washington: 2019), pp. 17–20, available at <https://www.irs.gov/pub/irs-pdf/p1415.pdf>.
- 11 *Ibid.* There are small differences in compliance rates, but the IRS emphasizes that they may be more attributable to changes in the study’s methodology than to actual changes over time. See, for example, Joint Committee on Taxation, “Overview of the Tax Gap” (Washington: 2019), p. 2, available at <https://www.jct.gov/publications.html?func=startdown&id=5185>; Eric Toder, “What is the Tax Gap?” (Washington: Urban Institute, 2007), available at <https://www.urban.org/sites/default/files/publication/46126/1001112-What-is-the-Tax-Gap-.PDF>.
- 12 Congressional Budget Office, “Monthly Budget Review – Summary for Fiscal Year 2013” (Washington: 2013), p. 4, available at https://www.cbo.gov/system/files/2018-09/44716-MBR_FY2013.pdf.
- 13 See Congressional Budget Office, “Budget and Economic Data: 10-Year Budget Projections (Jan. 2012, Feb. 2013, Feb. 2014),” available at <https://www.cbo.gov/about/products/budget-economic-data#3> (last accessed March 2020).
- 14 Jeff Stein, “27 Senate Democrats get behind a big new plan to make a child care entitlement,” *Vox*, September 14, 2017, available at <https://www.vox.com/policy-and-politics/2017/9/14/16307090/child-care-senate-democrats>.
- 15 Annie Lowrey, “Homeless Rates in U.S. Held Level Amid Recession, Study Says, but Big Gains are Elusive,” *The New York Times*, December 10, 2012, available at <https://www.nytimes.com/2012/12/10/us/homeless-rates-steady-despite-recession-hud-says.html>.
- 16 The House Committee on Transportation and Infrastructure, “Moving America and the Environment Forward” (Washington: 2020), available at <https://transportation.house.gov/imo/media/doc/Moving%20Forward%20Framework.pdf>.
- 17 Charles O. Rossotti, “Recover \$1.6 Trillion, Modernize Tax Compliance and Assistance,” *Tax Notes*, March 2, 2020, available at <https://www.taxnotes.com/tax-notes-federal/compliance/recover-16-trillion-modernize-tax-compliance-and-assistance/2020/03/02/2c5p2>.
- 18 IRS, “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013.”
- 19 *Ibid.*, Table 2.
- 20 *Ibid.* p. 20.
- 21 *Ibid.*, Table 5.
- 22 Andrew Johns and Joel Slemrod, “The Distribution of Income Tax Noncompliance,” *National Tax Journal* 63 (3) (2010): 397–418. The Johns-Slemrod estimates are based on somewhat old tax data from tax year 2001, but the patterns they identified still hold, and strongly imply that the tax gap is still overwhelmingly attributable to high-income taxpayers. Most importantly, capital income—for example, business profits and capital gains—which has relatively high noncompliance rates, is concentrated among high-income households and has grown as a share of overall income since 2001. See Bipartisan Policy Center, “Tax Administration: Compliance, Complexity, and Capacity” (Washington: 2019), p. 13, available at <https://bipartisanpolicy.org/wp-content/uploads/2019/04/Tax-Administration-Compliance-Complexity-Capacity.pdf>.
- 23 Lawrence H. Summers and Natasha Sarin, “Yes, our tax system needs reform. Let’s start with this first step,” *The Washington Post*, November 17, 2019, available at https://www.washingtonpost.com/opinions/yes-our-tax-system-needs-reform-lets-start-with-this-first-step/2019/11/17/4d23f8d4-07dd-11ea-924a-28d87132c7ec_story.html.
- 24 Johns and Slemrod, “The Distribution of Income Tax Non-compliance,” p. 412.
- 25 See Joshua D. Glogower and Ari Blank, “Progressive Tax Procedure” (New York: New York University School of Law, 2019), pp. 10–11, available at <https://www.law.nyu.edu/sites/default/files/Progressive%20Tax%20Procedure%20-%20Blank.pdf>. These analyses look only at individual income taxes. It stands to reason that high-income taxpayers would be the primary beneficiaries of the \$32 billion net corporate tax gap, since corporations are owned overwhelmingly by high-income individuals. High-income owners of businesses—both corporate and noncorporate—are undoubtedly responsible for a large share of the \$77 billion net employment tax gap as well. And though the estate tax gap is relatively small in the IRS’ analysis at a net \$1 billion, estate tax noncompliance would tend to benefit wealthy heirs.

- 26 J. Russell George, "Understanding the Tax Gap and Taxpayer Noncompliance," Testimony Before the House Committee on Ways and Means, Treasury Inspector General for Tax Administration, May 9, 2019, p. 6, available at https://www.treasury.gov/tigta/congress/congress_05092019.pdf. See also J. Russell George, "IRS Oversight: Treasury Inspector General for Tax Administration," Testimony Before the House Committee on Appropriations Subcommittee on Financial Services and General Government, Treasury Inspector General for Tax Administration, September 26, 2019, available at https://www.treasury.gov/tigta/congress/congress_09262019.pdf.
- 27 Gabriel Zucman, "Taxing Across Borders: Tracking Personal Wealth and Corporate Profits," *Journal of Economic Perspectives* 28 (2014): 121–148, available at <https://gabriel-zucman.eu/files/Zucman2014JEP.pdf>.
- 28 Andrew Prokop, "All the crimes Paul Manafort was just convicted of," *Vox*, August 21, 2018, available at <https://www.vox.com/2018/8/21/17692626/manafort-guilty-charges-verdict>.
- 29 IRS Revenue Ruling 77-44, 1974-1 C.B. 287.
- 30 See Karen Burke, "Exploiting the Medicare Tax Loophole," *Florida Tax Review* 21 (2018): 584–585, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3041694; Government Accountability Office, "Actions Needed to Address Noncompliance with S Corporation Tax Rules" (Washington: 2009), available at <https://www.gao.gov/new.items/d10195.pdf>.
- 31 For a striking example of this kind of strategy, see Paul Kiel, "The IRS Decided to Get Tough Against Microsoft. Microsoft Got Tougher.," *ProPublica*, January 22, 2020, available at <https://www.propublica.org/article/the-irs-decided-to-get-tough-against-microsoft-microsoft-got-tougher>.
- 32 The amount of revenue lost to profit shifting is significantly less than before the 2017 Tax Cuts and Jobs Act (TCJA), in part because of provisions that were aimed at curbing the use of tax havens but mostly because the United States is collecting less revenue in general from the corporate tax because of the TCJA's steep corporate tax rate reduction. See Kimberly Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act" (Portland, OR: Reed College, 2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3274827.
- 33 Michael Cooper and others, "Business in the United States: Who Owns It and How Much Tax Do They Pay?" (Cambridge, MA: National Bureau of Economic Research, 2015), p. 3, available at <https://www.nber.org/papers/w21651>.
- 34 Government Accountability Office, "Partnerships and Corporations: IRS Needs to Improve Information to Address Tax Noncompliance" (Washington: 2014), available at <https://www.gao.gov/assets/670/663185.pdf>.
- 35 David Kamin and others, "The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation," *Minnesota Law Review* 103 (2018): 1439–1521, available at http://www.minnesotalawreview.org/wp-content/uploads/2019/07/5Kamin_FINAL.pdf.
- 36 Joint Committee on Taxation, "Overview of the Tax Gap," pp. 7–8.
- 37 Kim Bloomquist, "The Tax Gap: Holding Steady or Missing in Action?," *Tax Notes*, October 28, 2019, available at <https://www.taxnotes.com/tax-notes-federal/information-reporting/tax-gap-holding-steady-or-missing-action/2019/10/28/2b1p7>.
- 38 Of note, Congress enacted the Foreign Account Tax Compliance Act in 2010 and established a new partnership audit regime in 2015. Congress also strengthened capital gains tax enforcement by mandating that brokers report the tax "basis" of securities starting in 2011. As Kim Bloomquist notes, however, the most recent Tax Gap report finds that misreporting of capital gains income increased from the 2008–2010 period to the 2011–2013 period. He suggests further research is needed. *Ibid.*, pp. 593–594.
- 39 Emily Horton, "2018 Funding Bill Falls Short for the IRS," *Center on Budget and Policy Priorities*, March 23, 2018, available at <https://www.cbpp.org/blog/2018-funding-bill-falls-short-for-the-irs>.
- 40 Author's calculations based on Bureau of Labor Statistics Consumer Price Index for All Urban Consumers (CPI-U). U.S. Bureau of Labor Statistics, "Consumer Price Index for All Urban Consumers: All Items in U.S. City Average," Federal Reserve Economic Data, available at <https://fred.stlouisfed.org/series/CPIAUCSL> (last accessed March 2020); IRS, "Data books for 2010–2018: Table 28, Table 30," available at <https://www.irs.gov/statistics/soi-tax-stats-irs-data-book-index-of-tables> (last accessed February 2020).
- 41 Author's calculations from IRS, "Data books for 2010 and 2018: Table 30" available at <https://www.irs.gov/statistics/soi-tax-stats-irs-data-book-index-of-tables> (last accessed March 2020).
- 42 *Ibid.*
- 43 IRS, "Data books for 2010 and 2018: Table 9b."
- 44 Tip Reporting Alternative Commitment, "Millionaires and Corporate Giants Escaped IRS Audits in FY 2018," March 7, 2019, available at <https://trac.syr.edu/tracirs/latest/549/>.
- 45 *Ibid.*
- 46 IRS, "Data books for 2010 and 2018: Table 9a."
- 47 Treasury Inspector General for Tax Administration, "Initial Compliance Results Warrant a More Data-Driven Approach to Campaign Issue Selection," September 27, 2019, available at <https://www.treasury.gov/tigta/auditreports/2019reports/201930066fr.pdf>.
- 48 ProPublica has found that the number of audits ending in disagreement between large corporation and the IRS declined from 190 in 2010 to only 25 in 2018. See Kiel, "The IRS Decided to Get Tough Against Microsoft. Microsoft Got Tougher."
- 49 Treasury Inspector General for Tax Administration, "Declining Resources Have Contributed to Unfavorable Trends in Several Key Criminal Investigation Business Results" (Washington: 2017), available at <https://www.treasury.gov/tigta/auditreports/2017reports/201730073fr.pdf>.
- 50 IRS, "Data books for 2010–2018: Table 30."
- 51 IRS, "Data books for 2012–2018: Table 18." Figures include investigations of legal-source tax crimes but not investigations that are not primarily tax-related, such as illegal-source financial crimes or narcotics-related crimes, where the IRS performs investigations in conjunction with other law enforcement agencies.
- 52 Jesse Eisinger and Paul Kiel, "After Budget Cuts, the IRS' Work Against Tax Cheats is Facing Possible Collapse," *ProPublica*, October 1, 2018, available at <https://www.propublica.org/article/after-budget-cuts-the-irs-work-against-tax-cheats-is-facing-collapse>.
- 53 J. Russell George, "IRS Oversight: Treasury Inspector General for Tax Administration."

- 54 Jim Buttonow, "Few audits hinder the IRS ability to close the tax gap," *IRS Mind*, June 10, 2019, available at <https://www.irs.mind.com/audits/few-audits-hinder-the-irs-ability-to-close-the-tax-gap/>.
- 55 Treasury Inspector General for Tax Administration, "Despite Spending Nearly \$380 Million, the Internal Revenue Service Is Still Not Prepared to Enforce Compliance with the Foreign Account Tax Compliance Act" (Washington: 2018), available at <https://www.treasury.gov/tigta/auditreports/2018reports/201830040fr.pdf>. See also Government Accountability Office, "Foreign Asset Reporting: Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad" (Washington: 2019), available at <https://www.gao.gov/assets/700/698133.pdf>. See also Eisinger and Kiel, "After Budget Cuts, the IRS' Work Against Tax Cheats is Facing 'Possible Collapse'"
- 56 Bloomberg Tax, "IRS Hired About 9,700 People This Year—Thousands More on the Way," November 14, 2019, available at <https://news.bloombergtax.com/daily-tax-report/irs-hired-about-9-700-people-this-year-thousands-more-on-the-way>.
- 57 Senate Finance Committee, "Full Committee Hearing – The 2019 Tax Filing Season and the 21st Century IRS," April 10, 2019, available at <https://www.finance.senate.gov/hearings/the-2019-tax-filing-season-and-the-21st-century-irs>.
- 58 House Ways and Means Committee, "Understanding Tax Gap and Taxpayer Noncompliance," available at <https://waysandmeans.house.gov/legislation/hearings/understanding-tax-gap-and-taxpayer-noncompliance> (last accessed March 2020).
- 59 Kiel, "Who's Afraid of the IRS? Not Facebook."
- 60 Michelle Nessa and others, "How do IRS resources affect the tax enforcement process?" (Athens, GA: Tull School of Accounting, University of Georgia, 2016), available at <https://www.ntanet.org/wp-content/uploads/proceedings/2016/158-nessa-schwab-stomberg-towery-irs-resources-paper.pdf>.
- 61 IRS, "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013," p. 21.
- 62 For example, the PATH Act of 2015 accelerated the due date for filing of information returns and required the IRS to delay payment of refunds on tax returns claiming the earned income tax credit or refundable child tax credit until February 15 of each filing year. These measures are also not reflected in the Treasury Department's latest annual estimates of EITC "improper payments." See National Taxpayer Advocate, "Annual Report to Congress 2018, Volume One" (Washington: 2018), p. 94, available at <https://taxpayeradvocate.irs.gov/reports/2018-annual-report-to-congress/full-report>.
- 63 IRS, "SOI Tax Stats – Individual Income Tax Returns Publication 1304 (Complete Report): Table 1.1 and Table 2.5 (tax year 2017), available at <https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report> (last accessed March 2020); IRS, "Data book for 2018: Table 9a."
- 64 Elaine Maag and Robert Weinberger, "To Help Close The Tax Gap The IRS Should Focus On Small Business Compliance, Not EITC Claimants," Tax Policy Center, March 14, 2019, available at <https://www.taxpolicycenter.org/taxvox/help-close-tax-gap-irs-should-focus-small-business-compliance-not-eitc-claimants>.
- 65 Paul Keil, "It's Getting Worse: The IRS Now Audits Poor Americans at About the Same Rate as the Top 1%," *ProPublica*, May 30, 2019, available at <https://www.propublica.org/article/irs-now-audits-poor-americans-at-about-the-same-rate-as-the-top-1-percent>.
- 66 Kim Bloomquist, "Regional Bias in IRS Audit Selection," *Tax Notes*, March 19, 2019, available at <https://www.taxnotes.com/tax-notes-today/audits/regional-bias-irs-audit-selection/2019/03/19/2957w?highlight=bloomquist>; Paul Kiel and Hannah Fresques, "Where in the U.S. Are You Most Likely to be Audited by the IRS?," *ProPublica*, April 1, 2019, available at <https://projects.propublica.org/graphics/eitc-audit>.
- 67 *Ibid.*
- 68 For example, a unique provision in the tax code allows the IRS to ban otherwise-eligible taxpayers from claiming the EITC for two years if it determines they claimed the credit improperly in past years—a provision that the National Taxpayer Advocate found was imposed improperly almost 40 percent of the time. See Internal Revenue Code section 32(k). Legal Information Institute, "26 U.S. Code § 32. Earned income, available at <https://www.law.cornell.edu/uscode/text/26/32> (last accessed March 2020); National Taxpayer Advocate, "2013 Annual Report to Congress, Volume One" (Washington: 2013), p. 107, available at <https://taxpayeradvocate.irs.gov/2013-Annual-Report/full-2013-annual-report-to-congress.html>. Also, the IRS is now required to delay payment of any refund on tax returns claiming the EITC or the refundable child tax credit until February 15, which is typically two to three weeks into the tax filing season. On the more onerous requirements and stiffer penalties for the EITC compared with other tax provisions, see generally Lawrence Zelenak, "Tax or Welfare: The Administration of the Earned Income Tax Credit," *UCLA Law Review* 52 (1867) (2005): 1867–1916, available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2269&context=faculty_scholarship.
- 69 Each correspondence audit costs the IRS approximately \$150, according to Commissioner Rettig. See Letter from Charles P. Rettig, U.S. Department of the Treasury, September 6, 2019, available at <https://www.documentcloud.org/documents/6430680-Documents-2019-9-6-Treasury-Letter-to-Wyden-RE.html>.
- 70 National Taxpayer Advocate, "Annual Report to Congress 2018, Volume One," pp. 126–140.
- 71 *Ibid.*, p. 137.
- 72 Robert Greenstein, John Wancheck, and Chuck Marr, "Reducing Overpayments in the Earned Income Tax Credit" (Washington: Center on Budget and Policy Priorities, 2019), available at <https://www.cbpp.org/research/federal-tax/reducing-overpayments-in-the-earned-income-tax-credit>. There may be some selection bias here: Taxpayers with valid claims may have been more likely to seek out assistance from the Taxpayer Advocate Service.
- 73 National Taxpayer Advocate, "Annual Report to Congress 2018, Volume One," pp. 126–140. See also John Guyton and others, "The Effects of EITC Correspondence Audits on Low-Income Earners" (Cambridge, MA: National Bureau of Economic Research, 2019), available at <https://www.nber.org/papers/w24465.pdf>.
- 74 National Taxpayer Advocate, "Annual Report to Congress 2018, Volume One," pp. 126–140.
- 75 Letter from Ron Wyden, U.S. Senate, October 15, 2019, available at <https://www.finance.senate.gov/imo/media/doc/101519%20Wyden%20Response%20Letter%20to%20IRS%20on%20EITC%20Audits.pdf>. (referring to Wyden's request of Rettig at an April 2019 Senate hearing)
- 76 Letter from Charles P. Rettig, U.S. Department of the Treasury, September 6, 2019, available at <https://www.documentcloud.org/documents/6430680-Documents-2019-9-6-Treasury-Letter-to-Wyden-RE.html>.

- 77 Robert A. Weinberger, "Budget Blues for Tax Administration," Tax Policy Center, January 13, 2020, available at <https://www.taxpolicycenter.org/taxvox/budget-blues-tax-administration>.
- 78 Sara Estep, "Not Enough Cops on the Beat: IRS Cuts Have Benefited Wealthy Tax Cheats," Center for American Progress, April 11, 2019, available at <https://www.americanprogress.org/issues/economy/news/2019/04/11/468594/not-enough-cops-beat-irs-cuts-benefited-wealthy-tax-cheats/>.
- 79 William Hoffman, "IRS Brain Drain Crisis Already Here, Tax Pros Fear," Tax Notes, May 14, 2018, available at <https://www.taxnotes.com/tax-notes-federal/tax-system-administration/irs-brain-drain-crisis-already-here-tax-pros-fear/2018/05/14/281by?highlight=%22Highly%20trained%20and%20experienced%20%22>.
- 80 Janet Holtzblatt, "The Administration's IRS Budget Contains the Good, The Bad, and The Uncertain," Tax Policy Center, March 26, 2019, available at https://www.taxpolicycenter.org/taxvox/administrations-irs-budget-contains-good-bad-and-uncertain?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+taxpolicycenter%2Fblogfeed+%28TaxVox%3A+the+Tax+Policy+Center+blog%29.
- 81 Natasha Sarin and Lawrence Summers, "Shrinking The Tax Gap: Approaches and Revenue Potential" (Cambridge, MA: National Bureau of Economic Research, 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3488975.
- 82 Nathan Richman, "Federal Bar Association Section on Taxation: IRS's Data-Driven Tax Enforcement Approach Is Here to Stay," Tax Notes, March 18, 2019, available at <https://www.taxnotes.com/tax-notes-federal/criminal-violations/federal-bar-association-section-taxation-irss-data-driven-tax-enforcement-approach-here-stay/2019/03/18/297df?highlight=%22that%20have%20cyber%20background%22>. Helpfully, Congress acted last year to extend through 2025 the IRS' "critical pay" authority, which enables the agency to more quickly recruit employees with important skills, such as IT. IRS, "Taxpayer First Act – IRS Modernization," available at <https://www.irs.gov/newsroom/taxpayer-first-act-irs-modernization> (last accessed March 2020).
- 83 Government Accountability Office, "Information Technology: IRS Needs to Take Additional Actions to Address Significant Risks to Tax Processing" (Washington: 2018), p. 2, available at <https://www.gao.gov/assets/700/692861.pdf>; Stephen Mihm, "The IRS Really Needs Some New Computers," Bloomberg, April 17, 2018, available at <https://www.bloomberg.com/opinion/articles/2018-04-17/the-irs-computer-system-is-the-oldest-in-the-government?sref=5SRPfkRP>.
- 84 Government Accountability Office, "Information Technology: Federal Agencies Need to Address Aging Legacy Systems" (Washington: 2016), pp. 28–30, available at <https://www.gao.gov/products/gao-16-468>.
- 85 Nina E. Olson, "Testimony Before Hearing on Tax Filing Season Before the Subcommittee on Oversight, March 7, 2019," available at https://www.irs.gov/pub/irs-utl/national_taxpayer_advocate_testimony_wm_oversight_filing_season_hearing-3-7-2019.pdf.
- 86 See Frank R. Konkel, "The IRS System Processing Your Taxes is Almost 60 Years Old," Nextgov, March 19, 2018, available at <https://www.nextgov.com/it-modernization/2018/03/irs-system-processing-your-taxes-almost-60-years-old/146770/>.
- 87 National Taxpayer Advocate, "Annual Report to Congress 2019, Volume One" (Washington: 2018), pp. 23–33, available at <https://taxpayeradvocate.irs.gov/2019AnnualReport>.
- 88 Rossotti, "Recover \$1.6 Trillion, Modernize Tax Compliance and Assistance," pp. 1421–1422.
- 89 *Ibid.*, p. 1421.
- 90 Richman, "IRS's Data-Driven Tax Enforcement Approach is Here to Stay." See also Nathan Richman, "IRS Using Data Analytics and New Unit to Sift 1 Billion Records," Tax Notes, June 25, 2018, available at <https://www.taxnotes.com/tax-notes-today-federal/fraud-civil-and-criminal/irs-using-data-analytics-and-new-unit-sift-1-billion-records/2018/06/25/285rs>.
- 91 Government Accountability Office, "Tax Fraud and Non-compliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement" (Washington: 2018), pp. 25–29, available at <https://www.gao.gov/products/gao-18-544>.
- 92 IRS, "IRS Modernization Plan provides plan to improve services for taxpayers, tax community" (Washington: 2019), available at <https://www.irs.gov/newsroom/irs-modernization-plan-provides-plan-to-improve-services-for-taxpayers-tax-community>.
- 93 Rossotti, "Recover \$1.6 Trillion, Modernize Tax Compliance and Assistance," p. 1423. See also Sarin and Summers, "Shrinking The Tax Gap: Approaches and Revenue Potential."
- 94 Congressional Research Service, "Internal Revenue Service Appropriations, FY 2020" (Washington: 2020), available at <https://crsreports.congress.gov/product/pdf/IF/IF11323>.
- 95 National Taxpayer Advocate, "Annual Report to Congress 2019, Volume One," pp. 17–18.
- 96 Office of Management and Budget, "Appendix A – Scorekeeping Guidelines" (Washington: 2016), available at https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a11_current_year/app_a.pdf.
- 97 Rule 14 of the guidelines prevents scorekeepers from scoring the secondary effects of "direct"—also known as mandatory—spending on program administration. It provides that "no increase in receipts [i.e., revenues] or decrease in direct spending will be scored as a result of provisions of a law that provides direct spending for administrative or program management activities." Rule 3 has the effect of extending this practice to changes in discretionary spending. It provides: "Revenues, entitlements and other mandatory programs ... will be scored at current law levels ... unless Congressional action modifies the authorizing legislation." See Office of Management and Budget, "Circular A-11, Appx. A—Scorekeeping Guidelines" (Washington: 2018), p. 5, available at <https://www.whitehouse.gov/wp-content/uploads/2018/06/a11.pdf>. For more discussion of how the scorekeeping guidelines were developed and how they inhibit accurate scorekeeping for tax enforcement and similar activities, see Scott Levy, "Spending Money To Make Money: CBO Scoring of Secondary Effects," *Yale Law Journal* 7 (4) (2018): 936, available at <https://www.yalelawjournal.org/note/cbo-scoring-of-secondary-effects>. See also Janet Holtzblatt and Jamie McGuire, "Factors Affecting Revenue Estimates of Tax Compliance Proposals" (Washington: Congressional Budget Office, 2016), available at <https://www.cbo.gov/publication/52199>.
- 98 Patrick Driessen points out the absurdity of the inverse case: If Congress slashes the IRS' budget in half, it would score as reducing the deficit by \$5 billion with no effect on revenue collection. Patrick Driessen, "Scoring Rules Double-Stacked Against IRS Funding," Tax Notes, March 30, 2015.
- 99 Chuck Marr and Roderick Taylor, "Bipartisan Support for Budget Mechanism to Boost IRS Enforcement Is Promising First Step," Center on Budget and Policy Priorities, April 9, 2019, available at <https://www.cbpp.org/research/federal-tax/bipartisan-support-for-budget-mechanism-to-boost-irs-enforcement-is-promising>.

- 100 The CBO noted, "Because of the budget scorekeeping guidelines used by the Congress, the revenue changes attributable to this option would not be counted for budget enforcement purposes." See Congressional Budget Office, "Increase Appropriations for the Internal Revenue Service's Enforcement Initiatives" (Washington: 2018), available at <https://www.cbo.gov/budget-options/2018/54826>.
- 101 The Congressional Budget Office-Joint Committee on Taxation staff paper further explains, "Without additional specification of the policies, especially beyond 2016, CBO had no basis for estimating" the indirect effects. Holtzblatt and McGuire, "Factors Affecting Revenue Estimates of Tax Compliance Proposals," p. 16.
- 102 U.S. Department of the Treasury, "Budget for Fiscal Year 2017" (Washington: 2016), pp. 1050-1051, available at <https://obamawhitehouse.archives.gov/sites/default/files/omb/budget/fy2017/assets/tre.pdf>.
- 103 Alan Plumley, "The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results" (Washington: IRS, 2002), available at <https://www.irs.gov/pub/irs-soi/irsvtc.pdf>.
- 104 Alan Plumley, "The Determinants of Individual Income Tax Compliance, IRS Publication 1916 (Rev. 11-96)" (Washington: IRS, 1996), available at <https://www.irs.gov/pub/irs-soi/pub1916b.pdf>.
- 105 Jeffrey A. Dubin, *The Causes and Consequences of Income Tax Noncompliance* (New York: Springer Science+Business Media, 2012), location 2712 of 9662. See also Dubin, "Criminal Investigation Enforcement Activities and Taxpayer Noncompliance" (Washington: IRS Criminal Investigation, 2004), available at <https://www.irs.gov/pub/irs-soi/04dubin.pdf>. (finding that a \$25 million allocation to criminal enforcement would have a \$1.7 billion general deterrence effect, a ratio of 68-to-1)
- 106 Sarin and Summers, "Shrinking The Tax Gap: Approaches and Revenue Potential."
- 107 Congressional Budget Office, "Increase Appropriations for the Internal Revenue Service's Enforcement Initiatives" (Washington: 2018), available at <https://www.cbo.gov/budget-options/2018/54826>.
- 108 Jason DeBacker and others, "Once Bitten, Twice Shy? The Lasting Impact of IRS Audits on Individual Tax Reporting" (2017), available at https://www.jasondebacker.com/papers/DHTY_IndivAudit.pdf. The authors find that people who are audited report higher incomes over the six years following an audit.
- 109 Plumley, "The Determinants of Individual Income Tax Compliance."
- 110 IRS, "Data books for 2011 and 2018: Table 9a."
- 111 Eisinger and Kiel, "The IRS Tried to Take on the Ultra-wealthy. It Didn't Go Well." The "wealth squad" was the nickname given to the specialized team of auditors that the IRS called the "Global High Wealth Industry Group."
- 112 J. Russell George, "Understanding the Tax Gap and Taxpayer Noncompliance."
- 113 Ibid.
- 114 Ibid. See also Eisinger and Kiel, "The IRS Tried to Take on the Ultrawealthy. It Didn't Go Well."
- 115 "National Taxpayer Advocate, "Annual Report to Congress 2018, Volume One," p. 133.
- 116 Benjamin D. Herndon, "Written Testimony Before the House Ways and Means Committee," May 9, 2019, available at <https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/2019Final%20Herndon%20testimony%20HWM%20050919%20-%20written.pdf>.
- 117 Rossotti would apply his proposal to taxpayers with more than \$25,000 of business income and to passthrough businesses with more than \$25,000 of receipts. The \$170 billion estimate is for 2019 if the proposal were fully phased in, and it includes \$98 billion from individuals with business income and \$72 billion from medium-sized passthrough entities. For the Bush reform panel proposal, see President's Advisory Panel on Federal Tax Reform, "Simple, Fair, and Pro-Growth" (Washington: 2005), p. 128, available at <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Fix-Tax-System-2005.pdf>. Unlike the panel's proposal, Rossotti's proposal would not require taxpayers to segregate their business and personal bank accounts. Rossotti, "Recover \$1.6 Trillion, Modernize Tax Compliance and Assistance," p. 1415.
- 118 James R. McTigue Jr., "Tax Gap – Multiple Strategies are Needed to Reduce Noncompliance," Testimony before the Committee on Ways and Means, House of Representatives, Government Accountability Office, May 9, 2019, p. 15, available at <https://www.gao.gov/assets/700/698969.pdf>. The Obama administration also proposed requiring electronic filing for all partnerships and corporations with \$10 million or more in assets. See also U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals" (Washington: 2016), pp. 227-229, available at <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf>.
- 119 See, for example, IRS Private Letter Ruling 201604003 (August 24, 2015), available at <https://www.irs.gov/pub/irs-wd/201604003.pdf>.
- 120 Treasury Inspector General for Tax Administration, "Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance" (Washington: 2019), available at <https://www.treasury.gov/tigta/auditreports/2019reports/201930016fr.pdf>. See also J. Russell George, "Understanding the Tax Gap and Taxpayer Noncompliance," p. 5.
- 121 Gene L. Dodaro, "Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position," Testimony Before the U.S. Senate Committee on Finance, Government Accountability Office (Washington: 2015), available at <https://www.gao.gov/assets/680/672884.pdf>; U.S. Government Accountability Office, "Actions that Could Improve Rental Real Estate Reporting Compliance" (Washington: 2008), available at <https://www.gao.gov/assets/280/279828.pdf>.
- 122 Journal of Accountancy, "President Signs Repeal of Expanded 1099 Requirements," April 14, 2011, available at <https://www.journalofaccountancy.com/news/2011/apr/20114071.html>.
- 123 Government Accountability Office, "High-Risk Series: Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others" (Washington: 2017), p. 507, available at <https://www.gao.gov/assets/690/682765.pdf>.
- 124 J. Russell George, "Understanding the Tax Gap and Taxpayer Noncompliance."
- 125 Treasury Inspector General for Tax Administration, "Billions of Dollars of Nonfiler Employment Taxes Went Unassessed in the Automated 6020(b) Program Due Primarily to Resource Limitations" (Washington: 2019), available at <https://www.treasury.gov/tigta/auditreports/2019reports/201930069fr.pdf>.
- 126 National Taxpayer Advocate, "Annual Report to Congress 2018, Volume One," p. 107.

- 127 James R. McTigue Jr., "PAID TAX RETURN PREPARERS: In a Limited Study, Preparers Made Significant Errors," Testimony Before the U.S. Senate Committee on Finance, Government Accountability Office (Washington: 2014), available at <https://www.gao.gov/assets/670/662356.pdf>. See also Jason DeBacker and others, "Seeking Professional Advice: The Effects on Tax Preparers on Compliance" (2019), available at https://nta.confex.com/nta/2019/mediafile/ExtendedAbstract/Paper3116/Seeking_professional_Advice.pdf.
- 128 National Taxpayer Advocate, "Annual Report to Congress 2018, Volume One," p. 106.
- 129 *Loving v. Internal Revenue Service*, 917 F. Supp. 2d 67 (D.D.C. 2018), aff'd, 742 F.3d 1013 (D.C. Cir. 2014), available at [https://www.cadc.uscourts.gov/internet/opinions.nsf/B63C3129A4FE761985257C7C00539949/\\$file/13-5061-1479431.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/B63C3129A4FE761985257C7C00539949/$file/13-5061-1479431.pdf).
- 130 Chuck Marr, "Regulating the 'Wild West' of Tax Return Preparation," Center on Budget and Policy Priorities, April 26, 2019, available at <https://www.cbpp.org/blog/regulating-the-wild-west-of-tax-return-preparation>.
- 131 PaymentAccuracy, "Resources: 2018 Dataset," available at <https://paymentaccuracy.gov/resources/> (last accessed March 2020). The EITC is included in both the improper payments estimates and the tax gap estimates.
- 132 Congressional Research Service, "Improper Payments in High-Priority Programs: In Brief" (Washington: 2018), available at <https://crsreports.congress.gov/product/pdf/R/R45257>.
- 133 Richard Rubin, @RichardRubin, May 10, 2019, 11:22 a.m., Twitter, available at <https://twitter.com/RichardRubinDC/status/1126870190598311936?s=20>. In FY 2018, the Treasury Department also changed how it computes EITC improper payment rates in a way that inflated the estimates. See Robert Greenstein, John Wancheck, and Chuck Marr, "Reducing Overpayments in the Earned Income Tax Credit" (Washington: Center on Budget and Policy Priorities, 2019), available at <https://www.cbpp.org/research/federal-tax/reducing-overpayments-in-the-earned-income-tax-credit>.
- 134 Holtzblatt and McGuire, "Factors Affecting Revenue Estimates of Tax Compliance Proposals," p. 22.
- 135 Bloomquist, "The Tax Gap: Holding Steady or Missing in Action?," p. 597.
- 136 See IRS Research, Analysis & Statistics, "The Feasibility of Estimating the Offshore Portion of the Individual Income Tax Gap" (January 2015 draft), on file with author.
- 137 Eisinger and Kiel, "The IRS Tried to Take on the Ultra-wealthy. It Didn't Go Well."

Our Mission

The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action. Our aim is not just to change the conversation, but to change the country.

Our Values

As progressives, we believe America should be a land of boundless opportunity, where people can climb the ladder of economic mobility. We believe we owe it to future generations to protect the planet and promote peace and shared global prosperity.

And we believe an effective government can earn the trust of the American people, champion the common good over narrow self-interest, and harness the strength of our diversity.

Our Approach

We develop new policy ideas, challenge the media to cover the issues that truly matter, and shape the national debate. With policy teams in major issue areas, American Progress can think creatively at the cross-section of traditional boundaries to develop ideas for policymakers that lead to real change. By employing an extensive communications and outreach effort that we adapt to a rapidly changing media landscape, we move our ideas aggressively in the national policy debate.

