Treasury Releases Report on the American Families Plan's Tax Compliance Agenda

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Report Details Investment in the IRS to Improve Tax Compliance

WASHINGTON: Today, the U.S. Department of the Treasury released a report on a set of tax compliance measures to increase fairness in the tax system and foster a tax system where Americans pay the taxes they owe. These measures are part of President Biden's recent proposals in the American Families Plan, with the goal of advancing comprehensive and necessary investments in American children and families.

This report describes the President's tax compliance initiatives that seek to close the "tax gap"—the difference between taxes owed to the government and actually paid. According to Treasury analysis, the tax gap totaled nearly $600 billion in 2019 and will rise to about $7 trillion over the course of the next decade if left unaddressed—roughly equal to 15% of taxes owed. These unpaid taxes come at a cost to American households and compliant taxpayers as policymakers choose rising deficits, lower spending on necessary priorities, or further tax increases to compensate for the lost revenue.

The magnitude of the tax gap means that compliance initiatives have the potential to raise substantial revenue, but these reforms also improve tax progressivity and economic efficiency. While roughly 99% of taxes due on wages are paid to the Internal Revenue Service (IRS), compliance on less visible sources of income is estimated to be just 45%.

To raise revenue, improve efficiency, and build a more equitable tax system, investments in tax compliance are of first order importance. The compliance proposals in the American Families Plan provide the IRS with the resources and information it needs to overhaul and enhance tax administration. These policy changes are integral to addressing evasion, but they also prioritize improving taxpayer service and the experience of Americans as they navigate the tax system. Taxpayers would benefit from effective communication with the IRS, access to the tax credits to which they are entitled, and competent assistance as they file their taxes.

The President’s compliance agenda has several transformational elements:

1. Provide the IRS the resources it needs to address sophisticated tax evasion. The first step in the President’s tax administration efforts is a sustained, multi-year commitment to rebuilding the IRS, including nearly $80 billion in additional resources over the next decade. The IRS would grow manageably (no more than around 10% annually) but also have certain funding in place to make investments with large fixed costs—like modernizing information technology, improving data analytic approaches, and hiring and training agents dedicated to complex enforcement activities. This would make up the ground that the IRS has lost over the last decade. During this time, the IRS budget fell by about 20%, leading to a sustained decline in its workforce particularly among specialized auditors who conduct examinations of high-income and global high net worth individuals and complex structures, like partnerships, multi-tier pass-through entities, and multinational corporations.
2. Provide the IRS with more complete information. When the IRS can verify taxpayer filings with third-party information reports, such as the W-2 forms submitted by employers to report wages, compliance rates exceed 95%. Without third-party reporting, compliance rates fall below 50% and thus lead to an inequitable asymmetry in tax collections depending on the form in which income is accrued. The Government Accountability Office (GAO) and IRS agree that strengthening third-party reporting is one of the most effective ways to improve tax compliance. The President’s proposal leverages the information that financial institutions already know about the accounts that they house. Financial institutions would add information about total account outflows and inflows to existing reporting on bank accounts. Importantly, there are no added requirements for taxpayers. The IRS will be able to deploy this new information to better target enforcement activities, increasing scrutiny of wealthy evaders and decreasing the likelihood that fully compliant taxpayers will be subject to costly audits. As a result, voluntary compliance will rise through deterrence as would-be tax evaders realize that the IRS has an additional lens into previously unreported income streams.
3. Overhaul outdated technology to help the IRS identify tax evasion and serve customers. The IRS still relies on Individual and Business File Systems that date back to the 1960s—the oldest in the federal government. The result is decades upon decades of tax administration built upon a system that is written in a programming language that is no longer taught, and where new functions are added in a patchwork rather than integrated manner. Modernization funding would allow the IRS to address technology challenges

and develop innovative machine learning that can be deployed to better identify suspect tax filings, for example, by comparing returns to similarly situated taxpayers and historical filings in a way that the current IRS ecosystem does not allow. These resources would also support efforts to meet threats to the security of the tax system, like the 1.4 billion cyberattacks the IRS experiences annually. With a revitalized IRS, taxpayers would also be able to communicate with and receive guidance from the IRS in a clear, timely manner when questions arise. Further, modernized IT would help improve taxpayer service and ensure that the IRS is able to effectively and efficiently deliver tax credits to eligible families and workers, including recent expansions to the Child Tax Credit, the Earned Income Tax Credit, and the Child and Dependent Care Tax Credit proposed in the American Families Plan.

4. Regulating paid tax preparers and increasing penalties for those who commit or abet evasion. Taxpayers often make use of unregulated preparers who lack the training to provide accurate tax assistance. These preparers submit more returns than all other preparers combined, and taxpayers rely on their guidance, in part because of challenges in reaching the IRS in a timely manner when questions arise. In addition to the regulation of paid preparers and service improvements that would simplify tax filing, the President’s proposal includes additional sanctions for so-called “ghost preparers” who fail to identify themselves on the tax returns which they prepare.

Experts at the Treasury Office of Tax Analysis estimate that these initiatives would raise $700 billion in additional tax revenue over the next decade. This revenue is backloaded in the 10-year budget window as several of these new investments—such as hiring revenue agents capable of complex global high net-worth examinations and building the technological infrastructure to support a new information reporting regime—take years to reach their full potential. The revenue raised in the second decade amounts to $1.6 trillion.

These estimates are conservative because the revenue potential of additional resources for tax administration is based on return on investment (ROI) estimates from the IRS that only exist for adjustments detected through current enforcement-related activities. Benefits of other foundational shifts in tax administration that would result from this proposal—for example, overhauling and integrating IT systems and restoring trust in the IRS through timely support for taxpayers—are also unaccounted for. Moreover, although revenue estimates for increased information reporting include the effects of this regime on voluntary compliance, estimates for increased enforcement actions do not account for deterrent effects, which are generally considered qualitatively significant.

Read the full report here, and for more information, please visit https://home.treasury.gov/news/press-releases/jy0150.

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