

**HOUSE REPUBLICAN SUPPLEMENTAL IRS FUNDING
CUTS: ANALYZING THE IMPACT ON FEDERAL
LAW ENFORCEMENT AND THE FEDERAL DEFICIT**

HEARING
BEFORE THE
COMMITTEE ON FINANCE
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**HOUSE REPUBLICAN SUPPLEMENTAL IRS
FUNDING CUTS: ANALYZING THE IMPACT ON
FEDERAL LAW ENFORCEMENT
AND THE FEDERAL DEFICIT**

TUESDAY, MAY 16, 2023

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:06 a.m., in Room SD-215, Dirksen Senate Office Building, Hon. Ron Wyden (chairman of the committee) presiding.

Present: Senators Cantwell, Menendez, Carper, Brown, Bennet, Casey, Warner, Whitehouse, Cortez Masto, Grassley, Thune, Daines, Johnson, Tillis, and Blackburn.

Also present: Democratic staff: Patricio Gonzalez, Senior Investigator; Eric LoPresti, Detailee; Sarah Schaefer, Chief Tax Advisor; Joshua Sheinkman, Staff Director; and Tiffany Smith, Deputy Staff Director and Chief Counsel. Republican staff: Michael Gould, Detailee; and Don Snyder, Senior Tax Counsel.

**OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR
FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The Finance Committee will come to order.

In recent months, the committee has held three hearings, two with Commissioner Werfel and one with Secretary Yellen, in which Republicans have attacked the Inflation Reduction Act funding for the IRS. The first bill that the House Republicans passed in 2023 repealed the bulk of the funding.

Repeal is the centerpiece of Speaker McCarthy's default plan, which would also destroy 780,000 jobs and increase the odds of a recession. By all outward appearances, repealing this funding is the Republicans' top economic priority. That is why the Finance Committee meets this morning to break down, point by point, all the harm repealing would do, especially as part of the overall McCarthy plan.

First, I would like to focus on the major setback for criminal law enforcement. As a way to frighten typical taxpayers, Republicans have fabricated a whole score of stories about 87,000 armed agents busting down the doors at local businesses and people's homes. This is nonsense.

The truth is, the IRS has a modest but critically important team of law enforcement personnel. They work on busting human trafficking rings, drug cartels, and enablers of child exploitation. They

root out individuals and groups who finance the terrorists. They help crack down on criminal tax fraud and evasion, including the kind of evasion the Finance Committee identified with our 2-year investigation of how Swiss bank Credit Suisse enabled a group of dual U.S. and foreign citizens to cheat on paying U.S. taxes.

At the moment, the IRS Criminal Investigation division is working with partners in Ukraine to hunt down crooks who are evading sanctions on Russia. Recently, Criminal Investigation collaborated with the FBI, the Department of Justice, and law enforcement partners around the world on the largest fentanyl distribution takedown in history. It resulted in hundreds of arrests and the seizure of \$54 million and 850 kilograms of drugs, including the equivalent of millions of lethal doses of fentanyl.

Republican cuts reduced the workforce of Criminal Investigation special agents by 26 percent. Democrats passed IRA funding to help rebuild it, but Republicans now wish to repeal those funds. Others say that the funding ought to be targeted elsewhere. So to me, the question is, colleagues, if you want to cut this enforcement spending, which criminal activity do you propose letting slide: drug rings, money laundering, sex trafficking, child abuse?

Yesterday, addressing this issue, the committee received a letter from the Federal Law Enforcement Officers Association opposing the Republican plan. This is a group representing tens of thousands of Federal law enforcement officers from across dozens of agencies. Without objection, I will put that into the hearing record.

[The letter appears in the appendix beginning on p. 94.]

The CHAIRMAN. The second issue: coming off the smoothest tax filing season in many years, the McCarthy repeal plan would once again clobber taxpayer service and force Americans to spend hours waiting on hold, with all that music, for the IRS.

House Republicans are hiding the ball on this issue. The McCarthy plan would leave the temporary IRA funding for taxpayer service in place, and Republicans will insist that is proof that they are interested in maintaining better service.

Here is what the Republicans aren't telling the American people. The McCarthy plan would also hit the IRS with across-the-board budget cuts just like the ones that steadily wrecked taxpayer services before the Democrats were able to start fixing things last year. Nobody is asking for a return to 10- or 15-percent call response rates at the IRS.

Third, the McCarthy plan to repeal the IRS funding would lead to a \$120-billion increase in the deficit. How would this plan offset the deficit increase? By kicking people off their health insurance, increasing child hunger, worsening education, weakening border security—and those are just a few of the examples.

With that said, if you want to see who are the big winners of the McCarthy IRS defunding plan, it is billionaires and corporations who cheat on their taxes. The Inflation Reduction Act funding for the IRS was designed to make sure everybody paid what they owe. Repealing that funding is a \$191-billion giveaway to wealthy tax cheats.

The effect of Republican IRS cuts has been clear. From 2010 to 2017 when the Republicans cut most aggressively, in terms of the

IRS, audit rates for millionaires went down 77 percent; for large corporations, 44 percent; complex partnerships, down 80 percent.

Performing those audits takes a lot of hard work by skilled staff, and the IRS has lost 40 percent of those agents. Republican cuts shifted the burden of tax enforcement onto working people. That is because auditing them is easy. An audit of a simple individual's taxpayer return takes 5 hours on average. Auditing a higher-income tax cheat takes an average of 250 hours. Corporate audits and audits of large, complex partnerships can take even longer, sometimes several years. They require big teams with lots of expertise.

Republican budget cuts systematically dismantled much of that expertise in the previous decade, and the McCarthy plan would decimate it in the years ahead. I will close by saying the McCarthy plan, in my view, will lead to more tax evasion by the very, very wealthy; worse taxpayer service for law-biding Americans; and especially, colleagues—this is why I documented example after example—fewer prosecutions of drug cartel members, sex criminals, sanctions evaders, and money launderers. There is not a member I know of who supports those objectives, but that is what is really involved here.

Lots to discuss. I look forward to hearing from our witnesses. Senator Thune is our ranking member today. We always like working with him.

Senator Thune?

[The prepared statement of Chairman Wyden appears in the appendix.]

**OPENING STATEMENT OF HON. JOHN THUNE,
A U.S. SENATOR FROM SOUTH DAKOTA**

Senator THUNE. Thank you, Chairman Wyden, and while Ranking Member Crapo is unable to attend due to a prior commitment, it is a pleasure to briefly fill in on his behalf, and I look forward to continue working with all of my colleagues on this committee, especially in regard to responsible stewardship of taxpayer dollars.

Today, we are going to discuss the IRS's supplemental funding provided in the so-called Inflation Reduction Act. The chairman has particular interest in the House-passed Limit, Save, and Grow Act, and how it could impact IRS enforcement activities.

Since the Finance Committee has yet to hold a hearing dedicated specifically to the \$80-billion allocation, I find it curious that some prefer to focus on a House bill related to this funding, rather than the effectiveness or oversight of the funding itself. Nevertheless, here we are.

Last August, with the narrowest of majorities, Democrats gave the IRS approximately \$80 billion, a sum equal to six times the agency's 2022 budget. Of the \$80 billion provided the IRS, more than half, about \$46 billion, is directed toward enforcement activities, which includes increasing audits and hiring more enforcement agents.

But only 4 percent of the \$80 billion—4 percent—was earmarked for improving taxpayer services. That it is an overwhelmingly disproportionate amount directed to increased enforcement compared

to the taxpayer services. The National Taxpayer Advocate herself criticized the lopsided funding for enforcement.

Since the IRA's enactment, Democrats have doubled down and made calls to further super-size the IRS's enforcement arm. The President's budget seeks an additional \$29 billion, on top of the \$80 billion in supplemental funding to the IRS, for enforcement—again, in addition to the \$46 billion for enforcement the IRS received only months ago.

For context, the IRS's supplemental enforcement funding amount alone eclipses appropriations for Customs and Border Protection, which received approximately \$18 billion in total this year. Based on funding priorities, it seems the Democrats' intent is to create a bigger, more intrusive enforcement-focused agency without annual accountability to taxpayers and Congress.

While Republicans are open to discussions about IRS resources, efficiency, accountability, and improvements to taxpayer services should be prioritized, all of which are lacking in the Inflation Reduction Act. Some on the other side of the aisle will say that the IRS needed \$80 billion to address the tax gap, refill the agency's coffers, and tune up the agency's customer service. But that is hardly the case.

First, the tax gap. The difference between taxes owed and paid has been steady for decades, and this committee should pursue bipartisan measures to narrow it. But any such effort must strike the appropriate balance between taxpayer responsibilities and taxpayer rights. Simply flooding the IRS with \$80 billion in unchecked resources will not magically yield \$700 billion in additional tax revenue, a fanciful estimate that President Biden made 2 years ago.

Policymakers need to be honest about what is doable with respect to the tax gap, and instead focus on encouraging voluntary compliance, as the current and former National Taxpayer Advocates argue. It should also be noted that tax compliance levels in the U.S. remain substantially unchanged since at least the 1980s.

According to recent IRS data, about 84 percent of taxes were paid voluntarily and on time. After enforcement efforts and late payments were taken into account, about 86 percent of taxes were paid. As the former Taxpayer Advocate Nina Olson has said, most Americans pay their taxes voluntarily, and data show that increased enforcement adds a small fraction to what the government collects.

Second, IRS budgets have been generally stable for at least the past 2 decades. Aside from the agency's all-time high budget of 2010, which spiked under all-Democrat rule, the IRS's funding has remained broadly in line with historic norms.

The argument the Republicans have somehow starved the agency simply does not hold, and to the extent that IRS budgets have been out of the norm, there is a lot of direct correlation with the decline in employee head count that some of my Democrat colleagues claim. The IRS's employee head count has been declining for several decades, regardless of the growth or contraction of the IRS's budget across dozens of Congresses and multiple presidential administrations.

Third, the IRS's recent funding windfall lacks any binding reports or oversight measures. As Ranking Member Crapo recently

put it, and I quote, “The IRS has embarked on a spend first, plan later approach that is not transparent or responsible, and is a sure-fire recipe for error, waste, and mismanagement.” I have to say, I could not agree more.

The IRS’s Inflation Reduction Act strategic operating plan, which was recently released more than 45 days late, was big on platitudes but short on details. But I was interested and disturbed to learn from the plan that the IRS intends to spend \$3.8 billion of the allocated \$80 billion on “energy security.” Energy security, by the way, in this context, means implementing the IRA’s climate tax agenda. By almost any reasonable measure, the nonbinding plan is instructive in how ineffectual a plan is without timely updates, clear data on costs, and meaningful oversight from Congress. To address this gap and to better track taxpayer services, I introduced the IRS Funding Accountability Act with Senator Grassley, and the Increase Reliable Service Now Act with Senator Collins.

Pumping the brakes on new enforcement activities from the \$80-billion funding allocation until basic accountability measures are met does not amount to protecting wealthy tax cheats, as some have suggested. It is about the responsible stewardship of taxpayer dollars.

We have an excellent panel before us today. Thank you all for being here, and I look forward to hearing your testimony.

The CHAIRMAN. Thank you, Senator Thune, and we are going to have a spirited discussion. Let me introduce our guests.

Professor Sarin is an associate professor of law at Yale Law School, and she has talked with us often over the years on tax issues, and we appreciate her good work.

Mr. Fort is the director of investigations at Kostelanetz, LLP. He served as Chief of Criminal Investigation at the IRS, and I think his testimony today and his availability for questions will be very helpful.

Our next witness is Mr. Sepp, president of the National Taxpayers Union. He leads NTU’s government affairs effort. Before coming to NTU, he served with the St. Louis County Board of Elections and with the U.S. Senate campaign. I have talked to Mr. Sepp often over the years.

And then we have Mr. Chris Edwards, the Kilts Family Chair in Fiscal Studies at the Cato Institute.

All of these individuals are experienced. We are going to have a good debate. Let us start with you, Dr. Sarin. We are going to make your prepared remarks a part of the record in their entirety. If you could summarize your views, that would be very helpful.

Dr. Sarin?

STATEMENT OF NATASHA SARIN, Ph.D., ASSOCIATE PROFESSOR, YALE LAW SCHOOL, YALE SCHOOL OF MANAGEMENT; AND FORMER TREASURY COUNSELOR FOR TAX POLICY AND IMPLEMENTATION, NEW HAVEN, CT

Dr. SARIN. Chairman Wyden, Ranking Member Thune, and members of the committee, thank you for inviting me to share my views on the generational opportunity to improve our tax system presented by the Inflation Reduction Act’s \$80-billion investment in the IRS.

One of the privileges of my time at the Treasury Department was having a chance to travel and visit IRS campuses across the country. I traveled to Kansas City to meet employees who gifted each other the red pens they needed to circle line items on returns that they would transcribe by hand, because the IRS could not afford to buy them. I traveled to Austin, where unprocessed returns dating back to the pandemic were stacked in the cafeteria, because there was nowhere to store them. I traveled to Ogden, UT to an IRS job fair, where front-line employees were proudly recruiting future civil servants, describing the months they had spent in person at the outset of the pandemic ensuring that the tax system would continue to run.

The case for the Inflation Reduction Act's much-needed investment in this beleaguered agency is clear. That said, it is unlikely that the IRS is going to win a popularity contest any time soon. One IRS colleague explained the reality to me as such: no one likes the IRS, and that is okay. We are the tax collector. Who is going to like the tax guys?

Even though the IRS might not be the most popular part of the U.S. Government, it is among the most important. The agency collects 96 percent of the revenue that funds the government. It touches just about every American household and business each year.

Over the last several years, it was responsible for disbursing critical support to millions of families. It has done all this for far too long without the resources in place to serve American taxpayers, or administer the tax laws the way the American people deserve.

Now, thanks to the IRA, all that has changed. Already this filing season, the IRS achieved an 87-percent level of service, and those backlogs are gone, and IRS employees have their cafeteria back.

The IRS has also begun to overhaul its tax compliance efforts. This is an area where the agency's work has been subject to substantial confusion and misinterpretation. So I would like to make four points about noncompliance in our tax system, and the importance of the IRA's investment.

First, the tax gap—the difference between owed and collected taxes—is large, more than 2 percent of GDP on an annualized basis, or about \$600 billion a year. To get a sense of that magnitude, consider this. If the United States was able to collect the taxes that are already on the books absent any other changes, the deficit would shrink by nearly half.

Second, the tax gap is concentrated. The top 1 percent is responsible for nearly 30 percent of the measured tax gap, and that number is likely an understatement, because the IRS has struggled to estimate the noncompliance of high-income individuals and the corporations and pass-through entities that they own.

It is exactly here that an underresourced IRS has lost the most capacity. In the last decade, multimillionaire audits declined by more than 80 percent, and audit rates have been approximately zero for complex tax structures like partnerships, which represent more than 35 percent of business income today. So this is where new enforcement resources appropriately will be focused.

Third, there is a lot of revenue at stake. In my new paper with former Assistant Secretary for Tax Policy Mark Mazur, we esti-

mate that the IRA's investment in the IRS could raise around \$560 billion in new tax collection in this decade, and more than \$1.5 trillion over the course of the next 2 decades.

But fourth, this is about more than just revenue. It is about fairness. We have underinvested in the IRS for years. That has created an inequitable tax system where the vast majority of your constituents pay all that they owe, but some who earn income in opaque ways—disproportionately the wealthiest—do not.

That is why the IRA is so critical. To be sure, there is an implementation challenge ahead, but with multiyear funds and a Commissioner at the helm with both public- and private-sector management experience, the IRS is finally set up to succeed.

Yet it will need help. In the years ahead, it will be critical for Congress, in its oversight capacity, to continue to monitor the progress of the IRS. I am keen to talk with you about how to ensure this funding is spent in a diligent and careful way.

It will also be paramount to preserve and supplement, in the discretionary appropriations process, the historic investment the IRA made in our tax system and in our Nation's fiscal health.

Thank you. I look forward to your questions.

The CHAIRMAN. Thank you very much, Dr. Sarin. We will have questions, for sure.

[The prepared statement of Dr. Sarin appears in the appendix.]

The CHAIRMAN. Mr. Fort?

STATEMENT OF JOHN D. FORT, DIRECTOR OF INVESTIGATIONS, KOSTELANETZ, LLP; AND FORMER CHIEF, CRIMINAL INVESTIGATION, INTERNAL REVENUE SERVICE, WASHINGTON, DC

Mr. FORT. Thank you. Chairman Wyden, Ranking Member Thune, and members of the committee, thank you for the opportunity to discuss the need for consistent funding for the Internal Revenue Service to address both critical service updates for the taxpayer experience, and sufficient support for enforcement activities.

As the former Chief of the Criminal Division of the IRS or IRS CI, I have witnessed firsthand the important role that enforcement plays in promoting voluntary compliance with the Nation's tax laws. I understand that my role at this hearing today is to talk about the real-life impact of funding cuts on Federal law enforcement.

So let us start there, with law enforcement. The Criminal Investigation division is the sixth largest Federal law enforcement agency in the United States. There are currently about 2,100 special agents in IRS CI. The high-water mark for CI special agents was in the late 1990s, when IRS CI had approximately 3,600 special agents.

Even after the planned IRA-funded hiring, CI will not surpass that number. I think it is also important that we call these law enforcement personnel special agents and not just agents, to avoid any confusion with revenue agents who do enforcement on the civil side of the IRS.

This confusion in language and misrepresentation of facts over the last 6 to 9 months is careless and dangerous, and has been the

cause of threats to men and women who serve this country by investigating some of the most dangerous crimes in our Nation.

IRS CI is the only agency with the authority to investigate and recommend prosecution for violations of the Federal tax code. IRS CI forms the backbone of the voluntary compliance regime that our tax system depends upon. The fact that you can be incarcerated for committing felony tax crimes in the United States provides a strong deterrent to those looking to take unfair advantage over their neighbors and business competitors.

Because of this, you can literally draw a straight line on a graph that shows the decrease in compliance as staffing for CI goes down. Without sustained funding for rigorous enforcement, the system of voluntary compliance will continue to erode.

IRS CI services are in high demand by both the Department of Justice and by the U.S. Attorneys Offices around the country. There are simply not enough resources to sufficiently work all the priorities of the IRS and the DOJ. Unlike the civil side of the IRS, IRS CI does not have full control over the cases they work.

Every case worked by IRS CI, whether it is a tax case or another Federal criminal violation, is worked in partnership with the Department of Justice and the U.S. attorneys who prosecute the cases.

I witnessed firsthand the impact that IRS funding cuts have on enforcement. Difficult choices must be made, involving investigative priorities, and investigators had to walk away from many strong cases because there simply were not enough special agents to handle the demand for their expertise.

In addition to being the only Federal law enforcement agency authorized to investigate Federal criminal tax violations, CI also works a variety of high-profile, high-impact cases at the request of the Department of Justice, due to their financial investigative expertise that is unmatched.

CI participates in sanctions investigations involving Russian oligarchs, corrupt politicians, and those that facilitate the illicit movement of money on behalf of sanctioned individuals or organizations. Just last week, IRS CI made news by training three Ukrainian law enforcement agencies with the help of private-sector partners in cryptocurrency and cyber tools.

You may recall the high-profile case in 2019 called "Welcome to Video," a case initiated and held by IRS CI. This case led to the seizure of the largest darknet marketplace for child exploitation, resulting in over 330 arrests around the world and 23 kids saved who were being actively abused.

In 2020, CI led an investigation revolving around cryptocurrency fundraising for several terrorist organizations including Hamas, Al-Qaeda, and ISIS. This concluded in the largest crypto seizure tied to terrorists to date.

Earlier this month, the Attorney General announced results from Operation SpecTor, which was a coordinated international effort that spanned three continents to disrupt dark web fentanyl and opioid trafficking. CI led multiple cases under this umbrella operation.

These cases are not what you think of when you think of IRS Criminal Investigation. But the expertise and reputation the agen-

cy has developed in more than 100 years is exactly the reason that CI is needed on these cases. The men and women of IRS CI are often behind the scenes and do not seek the spotlight, but their extraordinary work is critical to the success of U.S. law enforcement efforts.

Chairman Wyden, Ranking Member Thune, and members of the committee, thank you again for the opportunity. I believe the additional funding provided for the IRS in the IRA is a long-overdue game-changer for the agency.

Thank you, and I welcome your questions.

[The prepared statement of Mr. Fort appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Fort.

Mr. Sepp, welcome.

**STATEMENT OF PETE SEPP, PRESIDENT,
NATIONAL TAXPAYERS UNION, WASHINGTON, DC**

Mr. SEPP. It is an honor to be here, Chairman Wyden, Senator Thune. I promise I will not present on all of these materials at once, but I do hope we will actually get to these materials. It is very important for all of us to recognize a few realities here today.

First of all, this amount of funding for the Internal Revenue Service has never been accompanied by so little detail. Case in point: the 1998 IRS Restructuring and Reform Act was preceded by a 200-page report, a 184-page long bill. The Taxpayer First Act of 2019 was preceded by upwards of 4 years' worth of hearings, stakeholder engagement, and a 250-page implementation report. We got nine paragraphs in the Inflation Reduction Act to describe an agency transformation.

We also need to recognize though, on the Republican side of the aisle, that the House bill clawing back the funding will never get past this committee, much less to the President's desk. We need to accept that reality. And the Democratic side, of course, I would hope, would accept the reality that Federal law enforcement agencies have always been built with guard rails, and Democrats have been at the forefront of doing that. Maybe we can come together with those realizations and figure out how to move forward.

Let us also realize that while we argue about how much money can be raised here, like revenue angels dancing on the head of the pin, there is the point to the pin, the sharp end, and that sharp end is going to affect everyone in America. We debate over a \$400,000 audit threshold. We are getting some clarity about that.

But the point is, in the strategic operating plan, the IRS is admitting that there will be other enforcement activities funded by the new money that will touch all taxpayers. Audits are just one tool in the compliance toolkit.

So it is with the revenue estimates. CBO has gone back and forth on how much money this IRA enforcement funding will raise. They say a net of \$100.4 billion. Is it 50.2? It is 150.6? That again misses the purpose. Unless we get the agency transformation right, those revenues are not going to materialize anyway. That is why we need to get to work on a number of important items to make sure this agency transformation is a success, not only for the agency, not only for raising revenues, but for taxpayers themselves.

How do you do it? There is a turnkey operation, the IRS Oversight Board, that has remained dormant since 2015. It still gets funded. Let us get nominees before this board. Let us create a safe space for the White House to do that. Get that board up and running.

Let us make sure we have off ramps for these new enforcement efforts. We need a working appeals process. Congress has spoken on this for the better part of 100 years. The IRS pushes back with rulemakings that limit the right to appeal.

We need global settlements that will allow the IRS to sweep aside issues in courts that are relatively noncontroversial, but are taking up a lot of resources. Settle those and move forward so you can focus your legal resources. Look at alternative dispute resolution. That is something that Senator Cornyn has introduced in legislation this year: the Small Business Taxpayer Bill of Rights.

We need to examine and evaluate in detail this funding cliff for taxpayer services and business modernization. That is coming up very quickly. Appropriations may not be this committee's purview, but you can certainly make recommendations in that regard.

We need to look at alternative compliance strategies. Compliance is the end, not enforcement, and there are many ways to get there. I will put in a word for tax simplification. Of course, that aids compliance. That is a whole other hearing topic in and of itself.

But let me say that there is plenty of bipartisan legislation—from Senator Grassley, from Senator Wyden, from Senator Cardin, former Senator Portman—lots that we can build on. And we are here to help with that, with the Taxpayers First Project, an assembly of Democrats, Republicans, former IRS officials, current experts in academia—all of them ready to help on this important project.

It is said you can walk and chew gum at the same time, that the IRS can do this. Well, they not only have to do that, they have to read a book, drive a car; they have to play a ping-pong game, and they have to be a lifeguard at a swimming pool all at once. That task is going to take a lot of building. Let us get to work now.

Thank you so much.

[The prepared statement of Mr. Sepp appears in the appendix.]

The CHAIRMAN. Okay. Thank you, Mr. Sepp.

Mr. Edwards?

**STATEMENT OF CHRIS EDWARDS, KILTS FAMILY CHAIR IN
FISCAL STUDIES, CATO INSTITUTE, WASHINGTON, DC**

Mr. EDWARDS. Thank you very much, Chairman Wyden.

While the IRA, as we have heard, includes \$79 billion of new mandatory funding for the IRS, 57 percent is going toward enforcement, but just 10 percent for taxpayer services and technology upgrades. In the President's budget, which includes this additional funding, enforcement spending will more than triple over the next decade. Enforcement outlays will grow from 38 percent of the IRS budget today to 61 percent a decade from now.

That funding is off-kilter. As Senator Thune mentioned, the National Taxpayer Advocate said, quote, "Funding in the IRA is disproportionately allocated for enforcement activities. Congress should reallocate IRS funding to achieve a better balance of taxpayer services needs and IT modernization."

I think that is correct. The CBO says that the \$79 billion of new funding will raise \$180 billion over 10 years. But that does not mean that the new enforcement spending is good for the economy. More aggressive enforcement would mean higher costs on taxpayers. Higher enforcement would mean collateral damage on law-abiding taxpayers, because the IRS makes many mistakes.

Consider disputes that end up in Tax Court. For cases closed in the last 5 years, the IRS only got 48 percent of the dollars it demanded via these. So the IRS made a mistake in half of those cases. Similarly, IRS auditing imposes collateral damage, because many audited taxpayers have already paid the correct amount. More than 40 percent of partnership audits result in no recommended changes.

For individuals earning more than \$5 million, almost 40 percent of audits result in no change. Given that those audits are driven by IRS algorithms, those are high shares of targeted taxpayers who did nothing wrong. Of course, the IRS needs to enforce. My point is that there are downsides, including higher costs for families and businesses who have already paid the correct amount.

Also, if you look at data from the GAO and elsewhere, the marginal benefits of audits decline as auditing increases. The latest Federal IRS estimate of the gross tax gap is \$540 billion, which is 2.6 percent of U.S. GDP. The IRS tax gap as a share of GDP has actually fallen a bit over the last 2 decades, from 3.3 percent back in 2001.

Over recent years, despite the decline in audit rates, the tax gap was 2.7 percent of GDP a decade ago; it is only 2.6 percent today. So, the extent of taxpayer errors and cheating has not increased. It has really not changed much at all. There are a number of studies that have compared tax gaps across countries. The studies, I think, are rough estimates, but they generally show that the U.S. tax gap is about the same or smaller than typical tax gaps in Europe.

There are three better ways to boost tax compliance than jacking up enforcement. First, keep tax rates low to reduce incentives for cheating. The average corporate tax rate across the OECD countries has plunged from 48 percent in the early 1980s to just 24 percent today. But corporate tax revenues as a share of GDP are actually higher now than they used to be. With lower rates, there is less incentive for avoidance and evasion.

Second, taxpayer compliance would rise if we improved IRS services and technologies. The new strategic operating plan from the IRS has tons of good ideas to make these improvements.

And third, Congress should simplify the tax code. Rising complexity invites abuse. The past Taxpayer Advocate said complexity, quote, “facilitates tax avoidance by providing criminals with opportunities to commit tax fraud.” I think that is exactly right. Unfortunately, rising tax complexity is making the IRS’s job much more difficult.

In a really interesting report last year, the GAO found that for high earners, the average audit hours per return has more than doubled since 2010. I think that reflects the rising complexity in the tax code.

Recently, all the expanded energy breaks in the tax code would cost billions of dollars for the IRS to administer, and they will generate higher compliance costs, more abuse, and more lobbying frankly, which is all pretty unproductive for the overall economy.

So in sum, the official IRS data show that the tax gap is not rising compared to GDP. Also, the U.S. tax gap appears modest compared to other countries. But we can reduce the tax gap by cutting tax rates, improving IRS services, and simplifying the tax code.

So my bottom line is, I think that with the \$79 billion in new IRS funding, some of that ought to be moved back away from enforcement activities and more towards the taxpayer services and the IT investment that the IRS is promising in their new strategic plan.

Thank you very much.

[The prepared statement of Mr. Edwards appears in the appendix.]

The CHAIRMAN. Thank you very much. All of you have been very helpful, and I am going to start with you, Mr. Fort. You were, from 2017 to 2020, Chief of Criminal Investigation at the IRS; is that correct?

Mr. FORT. Correct.

The CHAIRMAN. So recently, we learned about how this particular part of the IRS collaborated with other law enforcement agencies on the biggest fentanyl distribution takedown in American history: hundreds of arrests, seizure of millions and millions of dollars, 850 kilograms of drugs. I mean, this was the equivalent of millions of lethal doses of fentanyl.

And the office that you headed up was a key part of enforcement efforts from 2017 to 2020. So House Republicans now want to cut these IRS enforcement measures that we included by over \$45 billion. Now, they swear up and down that they are for law enforcement, but with respect to the people, the agents, we should be doing more with less.

So, when it comes to investigating complex financial crimes, the kind of work you did, the kind of work recently that the office where you were was part of in this whole effort, what are the implications of trying to go along with this Republican mantra, in the criminal area, of doing more with less?

Mr. FORT. Thank you for the question, Chairman Wyden. As I mentioned in my opening statement, IRS Criminal Investigation has a very broad jurisdiction of tax crimes. But also—as you mentioned and I mentioned in my opening comments—a very important relationship with the Department of Justice and other Federal agencies, investigating child exploitation, narcotics trafficking, the opioid epidemic.

Less money, less funding means less cases. And for the criminal side of the IRS, that means less tax cases, less sophisticated international tax cases, but also less involvement in the cases that you mentioned, this critical involvement with U.S. law enforcement investigating serious narcotics crimes including the opioid epidemic, terrorist financing, sanctions investigations, and a whole host of other priorities for U.S. law enforcement.

The CHAIRMAN. Let me ask you about another one, and that is offshore tax evasion. I am very pleased that our investigative staff

exposed just how a few American families were hiding hundreds of millions of dollars at Credit Suisse, and how one U.S. software executive managed to hide an astounding \$2 billion in income offshore for more than a decade.

Part of the reason why is, Republican budget cuts hamstrung this enforcement program from the get-go. In 2021, there were seven criminal investigations opened into offshore bank account violations. That number strikes me as preposterously low—preposterously low given the magnitude of offshore tax evasion out there, which has been estimated at about \$15 billion per year.

Again, let us hear about how the Republican mantra, doing more with less, is going to help us figure out where these wealthy tax cheats are hiding money offshore. It does not seem to me that what the Republicans are talking about is going to be helpful as we try to get the very people that we recently exposed.

Mr. FORT. So, it's another great question. There is tremendous work left to be done on international tax enforcement—on the criminal side and the civil side. Again, this work is critically important to what the IRS does.

There are more cases than the seven that you cited. There are many international cases, but there is so much more work to be done, and in cooperation with the civil side of the IRS—there are sophisticated schemes. More and more, it is very typical for IRS criminal investigations to involve some type of an international component.

These cases are incredibly manpower-intensive; they are typically multiagency investigations led by the Department of Justice that require legal processes to get evidence and witnesses from overseas. So, there is a lot more investment that could be made, and many more cases that can be worked in this area.

The CHAIRMAN. Let me ask one question of Dr. Sarin. We have appreciated all of the input on issues you have given us over the years. What do you think about this idea of auditing wealthy tax cheats, and somehow the Republican argument is going to get it done, with the IRS doing more with less? We have had now two specific examples—this huge fentanyl takedown, the Credit Suisse effort that Mr. Fort has talked about—talking about doing more with less.

What do you think the consequences of these cuts are in our effort to really go after the issue that you and others have been looking at for years, which is—we have the information on middle-class people. You know, they pay taxes with every paycheck. It is these wealthy tax cheats we have got to zero in on. Your thoughts about doing more with less as the Republicans are talking about?

Dr. SARIN. Yes. Thanks, Chairman Wyden. The reality is, the IRS cannot do more with less, and let me give you another precise example with respect to complex partnerships. In 2019, the IRS opened audits of 7,500 partnerships. It received more than 4 million partnership returns. That is an audit rate of .05 percent. The reality is, this is a signal to taxpayers that the IRS is simply outgunned. It has no capacity, and those who want to evade do so freely.

What these resources are going to mean for the IRS—and what not having these resources will mean for the IRS—is that finally,

the agency is going to have the capacity to hire the people required to pore through thousands of pages of incredibly complex structured, tiered partnerships that are owned by tiered partnerships, and designed as such precisely to be opaque in ways that are impossible to pierce, and to allow for evasion.

The CHAIRMAN. Thank you very much. All of you have been excellent.

I am just going to close with this. I am over my time, but Mr. Sepp talked about guard rails. We are all for guard rails. What I think you have said, Mr. Fort, and you have, Dr. Sarin, is that the McCarthy budget would do a lot more to unravel our ability to take down the wealthiest tax cheats.

It is not about guard rails in that McCarthy budget. It is about unraveling the ability to take them down.

Senator Thune?

Senator THUNE. Thank you, Mr. Chairman.

Mr. Sepp, you—given the overwhelmingly disproportionate funding towards enforcement activities compared to taxpayer services, would you agree that some of the IRA enforcement funds could be more effectively spent on improving customer service, and could you just elaborate on that point a bit?

Mr. SEPP. Thank you, Senator Thune. Yes, certainly they could. And the problem with the nine paragraphs in the Inflation Reduction Act that described how the IRS money will be devoted to various functions, I think it fails to account for overlap in the taxpayer services category, for example.

It specifies that certain amounts of funding will go to Taxpayer Advocate services and the enforcement side. Certain amounts of funding will go to litigation. In the IRS strategic operating plan, in the enforcement section, there is an item describing how the Service wants to put more people into appeals.

You have overlaps among the funding that we do not really understand yet, and I think we need to consider holistically that, yes, taxpayer services and other items can increase compliance.

At a recent symposium by the Tax Policy Center, Nina Olson, the former National Taxpayer Advocate, said we are good at measuring noncompliance, or at least we think we are when it comes to audit rates and the like. What about compliance when taxpayer services improve?

We have not measured that impact sufficiently. I think one of the most telling quotes came when Ernie Dronenburg, who was a former revenue official from California, made the equation this way. A 0.5-percent increase in voluntary compliance raises \$400 million a year for his State. Doubling the audit rate raises half that much.

Senator THUNE. So, would having the IRS update its IRS spending plan annually and requiring regular oversight hearings before the relevant committees of jurisdiction provide some of the greater accountability of the \$80 billion in funding that we are talking about here, and maybe if so, can you talk about how?

Mr. SEPP. Well, I think that Congress cannot go at it alone. There certainly has to be a series of reports set up for the agency to describe in detail where the money is going, and answering this

question of how exactly this funding for auditing high-income individuals is going.

There is of course the Criminal Investigation division, whose funding is very important, but Commissioner Werfel himself has said their hires for CID will be somewhere around 3 percent of the total they intend to hire. If we want to keep funding CID, that is a pretty minor amount of increase. We can do that.

There are other things, though, that have to come along with it, like preparing the IT infrastructure for going after cybercriminals. The Treasury Inspector General recently said that the IRS failed to meet 17 of 20 standard cybersecurity criteria developed government-wide.

If we are going to be dealing with the worst of the worst in cybercriminals going forward, we need to have a secure infrastructure that is not going to be hacked.

Senator THUNE. And the oversight and accountability that come with it.

So, Mr. Edwards, in your testimony you state that the IRS estimates show that the tax gap is not rising relative to size of the economy, and the U.S. tax gap appears to be moderate by international standards. Could you elaborate on how the U.S. tax gap stacks up against other countries, including those in the EU?

Mr. EDWARDS. There are a number of studies internationally. It is difficult to compare tax gaps between countries. Few countries do a detailed tax gap like our IRS does. But there are five or six studies I cite in my testimony that look at tax gaps across European countries and the United States.

Generally, our tax gap is lower as a share of GDP, which is a little surprising. I mean, Europe relies a lot on VAT taxes, which are actually easier to force compliance with than income taxes. And our tax gap has not increased over time.

You can look at IRS tax gap estimates back a few decades, and the tax gap has not increased. The important point with enforcement, I think, is that it is not all black and white. But there are diminishing benefits when you increase enforcement.

There is a fascinating chart in the GAO study last year on enforcement that shows if you look at people earning over \$5 million, today when they are audited, 40 percent of them have no tax change. A decade ago when the audit rate was higher, 60 percent of them had no change.

So, if you expand the auditing on wealthy people in this case, you make more errors. You go after a lot more people who have not cheated, who have not made errors. You know, one of the reasons is a lot of high-income folks, they hire expert CPAs and CPA companies who do not want to make mistakes. They have their reputations on the line.

If you look at the auditing data in the annual IRS Data Book, the folks at the top end actually on audit, their mistakes are smaller relatively than people in the middle. So I think it is a bit off base to say that there is all this cheating going on at the top end.

Of course, there is some. We need to enforce it. But the relative error and cheating at the top end is smaller actually than in the middle and at the bottom.

Senator THUNE. Thank you, Mr. Chairman. My time has expired.

The CHAIRMAN. Senator Grassley is next.

Senator GRASSLEY. Mr. Edwards, we hear from people at the administration that nobody under \$400,000 is going to be affected by all this additional money we put into the IRS. But at a recent hearing, Commissioner Werfel stated that this threshold will be based on total positive income, which is a measure of income that excludes losses.

So, won't basing the audit threshold on total positive income result in significantly larger audit pools than if the IRS used adjusted gross income or taxable income? Isn't this particularly true for small business owners?

Mr. EDWARDS. Right. So, the administration has promised that they will not increase audit rates for folks who earn under \$400,000 a year. But my understanding is, the IRS uses the total positive income metric to target their normal auditing.

So, when the Commissioner says that, uses the \$400,000, he is actually talking, as you said, about a broader pool, mainly small to mid-size businesses that actually may have AGI under \$400,000, but if they are looking at positive income without losses, you are going to get a much bigger pool.

I have not done the math to figure out exactly how many returns that is, but there will be a broader pool of businesses that are audited than just thinking about the \$400,000 as if it was AGI.

Senator GRASSLEY. Mr. Sepp, I was a member of the 1998 IRS Restructuring Commission. In that act, the IRS received multiple years of funding to upgrade its information technology. This funding was supposed to enable the IRS to replace its outdated Individual Master File and Business Master File, which still used technology dating back to the 1960s.

However, that attempt was plagued by cost overruns, lack of functionality, and to this day the legacy system persists. What steps could be taken, whether by IRS or Congress, to ensure that we do not end up 2 decades from now with the same legacy systems?

Mr. SEPP. Well, thank you, Senator. The Individual Master File is probably the central core of IRS data that needs to be upgraded and replaced. The Commissioner has set a very ambitious goal of trying to do that in the next few years. That could very well get delayed.

We saw a \$4-billion attempt in the late 1980s and early 1990s to try and update IMF. There was the enterprise case management system, where IRS basically ignored the advice of technological experts who were saying, "You are focusing on the wrong kind of contract and the wrong kind of upgrade."

I would say that, even though the IRS now has a CIO, a Chief Information Officer—we have an acting one right now, which is not ideal. You should really have a permanent one in place. But I would refrain that having consistent managerial oversight through something like the IRS Oversight Board that you and my boss worked on in the IRS Restructuring Commission would be ideal.

In fact, I know that there has been work done behind the scenes with members of this committee to try and make sure we never have this quorum problem with the Board again. That would be well worth looking at, to make sure we have managerial consist-

ency when these upgrades are made. Frankly, there is not enough money for business systems modernization in the IRA funding mix. The projections are, we will burn through about a third of that before another 2 fiscal years have passed.

That money is not going to be around for the upgrades, and it is a key foundation for everything else the IRS wants to do.

Senator GRASSLEY. Mr. Edwards, we often hear from people who are behind this massive amount of money that is going to be given to the IRS, that anyone who is not a tax cheat has nothing to worry about from increased IRS enforcement. Even if an audit results in no additional taxes due, a taxpayer can still spend countless hours and incur significant costs responding to the IRS.

Can you discuss the costs and burdens an IRS audit imposes on even an innocent taxpayer?

Mr. EDWARDS. Well, that is right. That is one of the downsides of increased enforcement: that the IRS makes lots of mistakes. And you know, I cited the statistic, for example, that if you look at Tax Court cases over the last 5 years, the IRS gets it wrong about half the time.

They only get—the Court decides that the IRS only gets about 48 percent of the money that they had demanded. And that is after the audit and appeal. These cases are brought to court, and the IRS only gets about half of the money. So there are a lot of false positives, I guess you could say, in IRS enforcement.

The more enforcing you do, the broader the pool of enforcement, the more mistakes the IRS is going to make. It causes, especially for 30 million small businesses, a lot of headaches and wasted time and effort defending against the IRS when people have done nothing wrong.

So, I had my own issue with the IRS that lasted—it took me about a year to handle. I had to hire lawyers, and I found out through that process that the IRS makes lots of mistakes. They misfile forms. The groups within IRS do not talk to each other. You cannot get anyone on the phone.

I could have resolved my issue in 15 minutes on the phone with an IRS employee. I had to hire a law firm, spend thousands of dollars to get the problem solved. I ultimately had to get the National Taxpayer Advocate to come to my aid, and we solved the problem.

But it just struck me that a lot of this is actually not—it does not have to do with money. It has to do with management in the IRS sharing data, having a common database, being able to call and get someone on the phone—like an airline reservation system, where they have your information in front of them—and being able to solve the problem a lot faster.

The CHAIRMAN. The time of my colleague has expired.

Senator Carper is next in order of appearance.

Senator CARPER. Thanks, Mr. Chairman. I did not realize I timed my arrival this well. We have a lot of hearings going on today, the run-up to a 2-week recess, and I think every chairman of a committee is trying to make sure they have their hearings done today and tomorrow as well. But we are grateful for you to be here, and I have a special interest in these issues. It goes back a long way.

But thank you for joining us today, and as someone who cares deeply about fiscal responsibility, I care about customer service. I

care hugely about customer service. When I was a little boy, I used to go back to West Virginia to my aunt and uncle's supermarket just off of the turnpike in Beckley, WV called Patton's Market.

You'd go into that store, and it would say "Welcome to Patton's Market, friendliest store in Beckley." My grandfather was a butcher. My aunt and uncle ran the place, and if you walked in that place, man they knew your name. If you needed a special cut of meat, my grandfather would get it for you.

If you needed home delivery, they would deliver. If you needed to charge it—this is before credit cards—they would charge it. But I learned a whole lot about treating other people the way you want to be treated. There is a great quote, I think it was Mark Twain: "People do not care how much you know until they know how much you care."

Isn't that a great—no, it was Teddy Roosevelt. That was Teddy Roosevelt. It is not a likely quote you hear. "People do not care how much you know until they know how much you care."

When I was Governor of Delaware, the Delaware Division of Revenue—which basically was the State version of the IRS—my last term, they won the Delaware Quality Award for best service of any government or nonprofit or business in the State.

So I highly valued, and I still highly value customer service. But I want to talk a little bit today, or ask you to talk a little bit today about the fiscal impact of cutting investments in the IRS rather than reducing our deficit. The repeal of the IRS funding in Speaker McCarthy's bill would unfortunately actually add nearly \$120 billion to the deficit.

It should not be a partisan issue to support the idea that people should pay the taxes that they owe. That is especially true for corporations and wealthy individuals, which make up a large share of the tax gap.

Dr. Sarin, how does funding for the IRS bolster the fiscal health of our Nation, and how would the repeal of these investments I just alluded to impact taxpayer compliance?

Dr. SARIN. Thank you for the question, Senator Carper. As you mentioned, the CBO has sort of commented on this question and has remarked that the IRA would raise nearly \$200 billion in new tax collections, or around \$115 billion net of the IRA investment over the next decade.

I have a new paper out with former Assistant Secretary for Tax Policy Mark Mazur this week that addresses this question as well, and we conclude that while directionally definitely right, we think that the IRA investments are likely to raise much more, around \$560 billion over the course of the next decade, and around \$1.5 trillion over the course of the next 2 decades.

The reason for that is that, as the IRS starts to build up enforcement capacity in these areas that you speak of, Senator Carper, global high-net-worth, complex partnerships, high-end evasion, where they essentially have no capacity today, what you are going to see is direct revenue coming in from those enforcement activities.

But what you are also going to see is, you are going to see taxpayer behavior adjust very substantially for these investments. And particularly for taxpayers who make errors that are identified

by the IRS, we know they are unlikely to make those same errors in future years. There is also a community deterrent effect when taxpayers and tax preparers realize that the IRS is on the beat. They adjust their behavior accordingly and are more compliant voluntarily.

Senator CARPER. Thanks.

One more quick question if I can. This tax filing season, we have already seen tremendous progress in the ability of the IRS to provide good customer service for taxpayers. It is really encouraging.

In fact, during the 2023 filing system, I think the agency was able to answer nearly 90 percent of phone calls. I have a friend who says, "Compared to what?" Well, compared to a year ago, when I think it was like 16 percent of calls being answered. So that's a huge improvement, and I think it is due in large part to the investments we have made in the IRS.

A question for you, Dr. Sarin. Can you talk just briefly about—and you have already on this a little bit—just a bit more about what the repeal of this funding would mean for customer service that the IRS provides to everyday taxpayers seeking support? Thank you.

Dr. SARIN. And it is entirely because of the investment you made. So the IRS was able to hire 5,000 new people to be on the phones. The level of service grew to 87 percent from 15 percent in 1 year. The IRS was able to digitize thousands more forms this year. The IRS cut phone wait times from 27 minutes to 4 minutes.

This filing season is proof in concept of what a resourced IRS is going to be able to deliver for taxpayers. But we are not at the level of customer service that your market is able to provide just yet. What the agency needs to do over the course of the next few years—and what you see them allude to in the strategic plan—is invest in taxpayer service that allows the IRS to meet taxpayers where they are.

So that means phone service. It also means in-person assistance at Taxpayer Assistance Centers. But what it also means is, you should be able to communicate with the IRS digitally and instantaneously if you want to on your phone, the way you can communicate with your financial institution today.

Senator CARPER. All right. Yes, thanks for the time.

The CHAIRMAN. The time of my colleague is up.

Senator Johnson?

Senator JOHNSON. Thank you, Mr. Chairman.

Mr. Edwards, first of all, I agree with you. I think the overall solution here is to simplify our tax code. That would solve all the problems. That is the root cause: a very complex tax code. I fear that the \$80 billion is just an \$80-billion band-aid. It is not going to work.

And of course, what I am concerned about—I expressed this with Commissioner Werfel as well—is that the \$80 billion will not be spent in an impartial way. I am highly concerned about partisanship in these Federal agencies, law enforcement and the IRS, and we've got two examples.

Mr. Chairman, I hope we can get your cooperation with trying to extract information on the IRS visit to, for example, journalist

Matt Taibbi. We got a response. It was a nonresponsive response, but we will continue to follow up on that.

But I want to talk about another thing that just popped up in the news in terms of partisanship. Mr. Chairman, you received a letter, together with Ranking Member Crapo and Senator Grassley, from the attorney for an IRS whistleblower who is claiming partisanship in a high-profile IRS investigation.

They are asking for whistleblower protection, and they are asking to be interviewed, and my understanding is that they do not want to be interviewed by the House and the Senate. They would like to do it one time. I have a request that you cooperate with their request. I would ask that you enter this letter into the record. Mr. Chairman, can you enter this letter into the record?

The CHAIRMAN. Without objection, so ordered.

[The letter appears in the appendix on p. 57.]

Senator JOHNSON. And I would also ask, if we do arrange that interview, I would like to be part of that interview. I would like to be present when we interview that whistleblower, because the news reports widely are assuming that that is Hunter Biden, and of course the chairman is always talking about wealthy tax cheats.

Well, let us describe a wealthy tax cheat. Hunter Biden became a board member on Burisma in April or May of 2014. Three years later, his financial advisor, business partner of the family, the Biden family financial advisor, Eric Schwerin, sends him an email saying, "Hey, Hunter, you understated your income by \$400,000 in 2014."⁵ I mean this is 2 or 3 years later, right?

Now eventually, Hunter Biden paid about \$2 million of delinquent taxes, but *he* did not pay them. A Hollywood attorney named Kevin Morris made that payment in May of 2022, 5 years after Mr. Schwerin told him that he underreported income by \$400,000. Well, he must have underreported income by a lot more than \$400,000 if he is making a \$2-million tax payment.

So the concern we have now, according to this letter, is that the entire IRS investigatory team has been pulled off the Hunter Biden case. My question for you, Mr. Fort, is, in your time in the IRS, in the investigatory division, the Criminal Division, was there ever another instance when an entire IRS investigatory team was pulled off a tax case?

Mr. FORT. Thank you for the question, Senator. So yes, I spent 30, almost 30 years with IRS Criminal Investigation. I am not aware of a situation such as that. But again, when I retired from the organization at the end of 2020, I was in charge of about 3,000 people, including 2,100 agents, so I cannot say with certainty whether or not that happened.

Senator JOHNSON. So again, we have a whistleblower here. He is seeking whistleblower protection. Sounds like the House has granted that. I am not sure what the Senate is doing, and this is the committee of jurisdiction. I hope you grant whistleblower protection and cooperate in an interview with this whistleblower, because we need to find out this information claiming partisanship in the Hunter Biden investigation.

And now, the fact that the Justice Department has removed the entire investigatory team off of the case, that just smacks of partisanship and erodes the American people's confidence that the IRS

will be fair and impartial and administer justice in the tax code equally. Do you agree that that erodes confidence in the IRS, this recent revelation?

Mr. FORT. So, even though I have been gone from the government for 2 years, Federal law prohibits me from discussing any specific taxpayer at all. But I would just agree that it is a serious allegation.

Senator JOHNSON. Well, again, having an entire IRS investigatory team pulled off of any case would certainly get you scratching your head, right, highly concerned about what is pulling off here?

Mr. FORT. Again, in my experience—you know, I am not personally aware of a situation such as that, but it does not mean it did not happen during my tenure.

Senator JOHNSON. Okay. And again, Mr. Chairman, I would also like your cooperation in my request for information from Commissioner Werfel on Matt Taibbi. We are going to try to get from Mr. Taibbi a release to have the IRS release those records, because right now the IRS is claiming it cannot do that.

We also asked, by the way, general questions, which the IRS also did not respond to. So, I am going to need your help if we are going to get to the bottom of that potential partisanship within the IRS.

The CHAIRMAN. I am going to respond when you are done. You are just over your time. Are you done?

Senator JOHNSON. Yes.

The CHAIRMAN. Great.

I am aware of the matter that Senator Johnson has brought up. As has been my practice on 6103-protected matters, I have been pursuing this issue on a bipartisan basis here with Ranking Member Crapo, and we are going to continue to do so.

Given 6103 and the sensitive nature of the information for all involved, there just is not anything more I can say about it now.

Okay. Senator Daines is next.

Senator DAINES. Mr. Chairman, thank you. I would like to begin my time by addressing the flawed notion that the Inflation Reduction Act's \$80 billion in supplemental funding to the IRS will somehow spare ordinary Americans from increased audits.

For years, my Democrat colleagues have called for the IRS to reduce the tax gap, the difference between total taxes owed and collected by targeting wealthy tax cheats. Fortunately, we still have some common sense in Montana. Montanans know that the most dangerous words in the English language are: "I'm from the IRS, and I'm here to help you."

They know the IRS cannot handle the workload it currently has, so adding more money to enforcement before we get folks to answer the phones is fruitless. The other problem is, low- to middle-income earners represent the major source of underreported income.

According to the nonpartisan Joint Committee on Taxation, as much as 90 percent of the money raised from underreported income would likely come from those making less than \$200,000 a year, with only 4 to 9 percent coming from those making more than \$500,000. Again, that is from JCT.

The nonpartisan GAO also found that most of the revenue generated from audits over the last decades has come from returns with incomes below \$200,000. In fact, when given a chance to guar-

antee the IRS could not use additional funding to audit taxpayers earning less than \$400,000, every Senate Democrat voted against it.

With nearly 60 percent of the IRS's supplemental funding going to tax enforcement, audits are unfortunately coming for Americans at all income levels. More aggressive IRS enforcement is likely to increase cost for honest taxpayers who are forced to spend time and a lot of emotional energy defending themselves against erroneous audits.

Mr. Edwards, in your testimony you state, and I quote, "IRS auditing imposes collateral damage because many audited taxpayers have paid the correct amount." What are some of the external consequences that taxpayers face as a result of the IRS's increased enforcement?

Mr. EDWARDS. We all want to increase compliance rates and, you know, there are two ways you can do it. You can improve the IRS. You can keep tax rates low. You can simplify the tax code. All of those strategies would save taxpayers money, and you would increase compliance.

Yes, you could increase compliance with higher audit rates, but as you said, there would be collateral damage on the many people who get audited, go through all the anguish, the lawyer costs, and all that financial uncertainty, and they paid the correct amount.

And as I said, in a GAO study on auditing last year, they have a chart showing a decade ago when audit rates were higher on the top income category above \$5 million, 60 percent of the time there was no change on audits for those taxpayers. Meaning the IRS, even though they target with algorithms, they made a mistake 60 percent of the time and went after the wrong people. So, I do not know what the exact audit rate is, but the more you audit, the more mistakes the IRS will make.

Senator DAINES. Mr. Edwards, in your testimony, you touched on this, on the prevalence of so-called "no change audits," in which the IRS audits taxpayers, only to find out that they paid the correct amount. In fact, you stated that for individuals earning more than \$5 million, the no change rate is just under 40 percent.

Meaning, in 40 percent of these cases, the IRS is expending time and resources forcing individuals to exhaust their own time and resources for no reason. Mr. Edwards, the Biden administration has said that the enforcement budget will only go towards auditing high-income taxpayers.

I think it was already demonstrated that this is, at best, a flimsy claim. But let us say it is true for a moment. Is it a really good outcome for anyone besides tax attorneys to have the IRS increasing taxpayer costs and stress by forcing them to defend themselves in these audits?

Mr. EDWARDS. That is right. So that is a GAO statistic, that for the very top-end people, 40 percent of audits, there is no change. Even the returns where there are changes, a lot of those get abated. Some of them go to Tax Court, and in Tax Court, as I noted, the IRS only has about a 50-50 batting average.

So there are a lot of people—the more you audit, there are a lot of people who have to go through a lot of time and expense and fi-

nancial anguish and lawyer fees to defend themselves when they have done nothing wrong.

The CHAIRMAN. The time of my colleague has expired.

Senator Casey is next.

Senator CASEY. Thank you, Mr. Chairman. I want to thank the witnesses for being here for your testimony.

I want to start with Dr. Sarin. We are grateful for your presence here today, and I wanted to specifically talk about the question of performance and what has happened just in our recent history.

You mention in your testimony the IRS has increased its customer service performance 315 percent over the year, answering 2 million more calls this year and serving 100,000 more taxpayers in person. The IRS has also digitized returns, cleared paper backlogs, and reduced processing times on tax returns.

That means, obviously, more taxpayer money is getting back into families' pockets. If the Congress were to cancel the increase in IRS funding, as House Republicans have proposed, what would happen to, number one, in-person taxpayer services and, number two, call wait times for people in Pennsylvania, for example?

Dr. SARIN. Well, call wait times would rise. Last year, without the IRA funding, call wait times averaged 27 minutes. This year, they average 4 minutes, and that is a direct result of your investment.

What would also happen is that in-person assistance at Taxpayer Assistance Centers would decline. It declined over the course of the last decade by 50 percent, disproportionately because the IRS was forced to close Taxpayer Assistance Centers in rural, low-income communities because it could not afford to staff them.

This year, it did a terrific job in increasing that in-person assistance, but there is a ways to go, and these investments are so, so critical. They are also critical in enabling taxpayers to have real-time access to the IRS, and real-time digital access to enable them to have their tax questions answered more quickly, and to quickly resolve any issues with the agency.

I know this is the direction that all of your constituents want the agency to go. They now finally have the resources to do it.

Senator CASEY. Thank you, Doctor.

I want to turn to Mr. Fort, and I am grateful for your public service as Chief of IRS Criminal Investigation.

Over the last decade, IRS Criminal Investigation has lost a quarter—one-quarter—of its special agents, who do the work of investigating criminal violations, dismantling terrorist financing operations, and recovering billions in stolen assets for American taxpayers. The House Republican proposal would make sure we never rehire those Criminal Investigation agents.

You have personally had a hand in some of the most high-profile investigations at the IRS, like when two Chinese nationals were charged with laundering \$100 million after hacking a cryptocurrency exchange. I want to ask you first about the special expertise that the IRS brings to criminal investigations. What kinds of criminals are able to escape justice when we defund the IRS?

Mr. FORT. Thank you for the question, Senator. So, IRS Criminal Investigation has very broad jurisdiction. I will direct the question primarily to the multiagency investigations that IRS Criminal In-

vestigation works, such as the case that you mentioned, child exploitation, many narcotics investigations around the country.

The IRS is in high demand. The resources of IRS Criminal Investigation are in high demand with the Department of Justice and other agencies. It is really a multiagency effort, where every agency brings their skills to the table, and it is the skills of IRS special agents in following the money that are so critical in solving these Federal crimes.

Senator CASEY. Well, I appreciate it, and how many—just for purposes of the record, how many years have you done this work?

Mr. FORT. I did it for a little over 29 years.

Senator CASEY. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague.

Senator Blackburn is next.

Senator BLACKBURN. Thank you, Mr. Chairman, and thank you all for being with us today.

So, the IRA gives the IRS an additional \$80 billion, and you have additional funding that is on top of the \$13.6 billion it received in annual appropriations in 2022, and about 60 percent of this funding is designated for enforcement actions.

And so, Dr. Sarin, you wrote an article in *The Washington Post* saying that this is not enough. So how much do you think would be enough? Where do you peg that number? When does government get enough of the taxpayers' money, or do they ever get enough?

Dr. SARIN. Thank you so much for your question, Senator Blackburn. I really appreciate it, and a point that I think is important to emphasize is that these \$80 billion, this \$80-billion investment in the agency is about transforming the IRS into a 21st-century tax administrator.

It is about creating modern IT structures so that IRS employees are not hand-transcribing returns. What they are doing instead is scanning them digitally and automatically when a—

Senator BLACKBURN. So, you think they need even more money on top of what they have gotten, so that they can audit more of the American people, and use technology to delve into those audits.

Mr. Sepp, I want to come to you. In a letter that the National Taxpayer Union wrote to Congress last year before the passage of the IRA, a section was included that speaks to what would happen if the IRS received increased enforcement funding, with the goal of aggressively pursuing increased revenue.

When I talk to Tennesseans, they do not agree with Dr. Sarin. They think the IRS has too much of their money as it is. The letter goes on to say, and I quote: "Taxpayers would be right to ask, would the agency first direct their efforts at expensive, time-consuming in-person audits of wealthy taxpayers and corporations, potentially facing legal challenges in the process, or would the IRS devote its time and manpower to additional correspondence audits from underresourced low- and middle-income taxpayers?"

Now of course, we know the IRS has only 50 to 55 percent of their personnel who are working in person. The rest of them are still working remotely, and if we also take into consideration that the Biden administration has chosen to keep audit rates at 2018 levels, that, according to the 2022 IRS Data Book, would still lead

to over 262,420 taxpayers making less than \$25,000 per year being audited.

So, do you believe that it is a valid concern for taxpayers that I hear from all the time, that they are concerned that the IRS is going to use this money as a slush fund to target them, to target small business people, and to cause them a lot of extra expense as you were just discussing with Senator Daines?

Mr. SEPP. Well, thank you, Senator. A lot to unpack there. I would just say first, we have the notion that innocent people have nothing to fear from heightened enforcement activities. That—

Senator BLACKBURN. But sometimes it costs them to prove their innocence, because the IRS many times considers them guilty—

Mr. SEPP. That is right—

Senator BLACKBURN [continuing]. Unless they can prove that—

Mr. SEPP. That is right, and we would never be making that statement with any other area of law enforcement, in my opinion. We would be saying “trust but verify.”

Senator BLACKBURN. Right.

Mr. SEPP. And in this report, of course, if you read the IRS’s strategic operating plan, they are very careful to point out in the enforcement section where they are talking about limiting audits at the \$400,000 TPI and up level, versus broad-based enforcement efforts that are going to affect all taxpayers—

Senator BLACKBURN. But as we have heard from Commissioner Werfel, that is going to be what he terms positive income, which is everything. That is your gross.

Mr. SEPP. Yes.

Senator BLACKBURN. That is not your net-net. That is your gross. That gets a lot of moms and pops.

Mr. Edwards, do you have anything to add to that?

Mr. EDWARDS. I agree with what Pete said. There is a heck of a lot of good stuff in the strategic operating plan regarding taxpayer service and technology. I think both sides can win. Taxpayers can win. We would all win if there is oversight on the IRS, to make sure that those promises are fulfilled.

We can save taxpayer money by investing in taxpayer service, holding their feet to the fire, making sure they make those customer service changes. It would be good for all of us. I would also say there is a lot of stuff in the strategic operating plan that actually should not really cost money.

I mean, there is a whole page in there on saying that forms and notices should be in plain language. Well, they should be doing that already. They should have been doing that for years, and as someone who has received some of those notices over the years, I can tell you, they are hard to read, which makes no sense.

Senator BLACKBURN. And it requires you to get an attorney.

Mr. EDWARDS. Absolutely.

Senator BLACKBURN. Which is costing you money, compliance, and you have done nothing wrong. We hear it from Tennessee businesses all the time.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague. I heard you say the strategic operating plan had plenty of good stuff in it. I heard it loud and clear.

Senator Whitehouse.?

Senator WHITEHOUSE. Thank you very much, Mr. Chairman.

Mr. Fort, I think we have talked a bit about what IRS—I used to call it CID when I was U.S. Attorney. And by the way, you were all terrific to work with. It was really an impressive law enforcement agency, so thank you for your service there.

We have heard about a number of the areas in which the criminal investigation work of the IRS takes place. Would it also include terrorist financing?

Mr. FORT. Thank you for the question, Senator Whitehouse. Yes, it would.

Senator WHITEHOUSE. And international money laundering?

Mr. FORT. Correct.

Senator WHITEHOUSE. And sanctions evasion, for instance by Russian oligarchs who park money in the U.S. and other places?

Mr. FORT. Yes.

Senator WHITEHOUSE. Thank you.

Dr. Sarin, I think you are familiar with the 501(c) programs of the tax code?

Dr. SARIN. I am.

Senator WHITEHOUSE. What is the status of 501(c) enforcement right now at the IRS?

Dr. SARIN. Well, Senator Whitehouse, I think this is an incredibly important area, and it is one like much of what we have talked about, like partnerships, like global high net worth, where the IRS has had resource constraints. They just have not been able to invest in this work.

It is part of what I think is so important going forward, because really investing in a tax administrator that is able to have a real enforcement presence across the code is kind of central to our democracy. It is central to the functioning of American society.

Right now, we live in a world with a two-tiered tax system, where the vast majority of their constituents are doing exactly what the IRS requests of them. But disproportionately, those on the high end are choosing not to, and disproportionately, certain organizations and large corporations and complex partnerships are causing the IRS to be in a situation where they are not complying with the law, and that is why this is so important.

Senator WHITEHOUSE. Specifically, 501(c)(3) and 501(c)(4) organizations, they are required to operate within fairly precise legal constraints, are they not?

Dr. SARIN. That is correct.

Senator WHITEHOUSE. But there does not seem to be much enforcement happening to keep them within those bounds set by Congress. Is that also correct?

Dr. SARIN. And this is an area where I know you have discussed this with Commissioner Werfel as well. This is an area where, and the analogy he used with you, I think, was, the IRS needs to have refs on the field in order for the rules to be followed and the game to be played.

I think this is an area where there is a considerable role for both Congress and the IRS to play, in making sure that we invest in the importance of enforcement and following the rules.

Senator WHITEHOUSE. Well, it looks like the Wild West, that the sheriff is sound asleep right now. So I hope that will change and that these resources will help.

Let us just propose a hypothetical here. Let us say, hypothetically, that one party of a country was supported by polluting industries, that it got away with enormous levels of pollution for free, putting the burden of its pollution on everybody else in the country, but not paying to prevent or clean up its own pollution; that as a result, vast fortunes were created, and that the owners of those vast fortunes deeply resent being taxed by ordinary people, and therefore set up complex schemes to hide their income and their assets, including even overseas.

If you were in that hypothetical as one of those individuals, would defunding the tax police be a logical strategy as a part of that operation?

Dr. SARIN. If you were one of those individuals, you certainly would want an IRS that is not resourced to be able to pursue you and your tax evasion and your crimes. I suspect—and it has been kind of disheartening to watch critics of the IRS line up and so much money be lined up against the IRS's activities here—that is exactly what you are seeing.

Senator WHITEHOUSE. I could not agree more.

I yield back my time.

The CHAIRMAN. I thank my colleague.

Senator Tillis is next.

Senator TILLIS. Thank you, Mr. Chair. Thank you all for being here.

Mr. Edwards, you have written extensively on the subject of the tax gap, and I think you found that the tax gap has not grown relative to the size of the economy. I am curious about that. Can you explain what it means?

Mr. EDWARDS. Well, you know, every few years the IRS does a tax gap study. They do it based on what is called the National Research Program, which is random audits. They take the random audit information. They sort of gross up the amounts compared to account for income that they think might be there but they cannot find, and then come out with their tax gap estimate.

They came out with their most recent one last year. They found that the tax gap now is around 2.6 percent of the GDP. If you look at the IRS studies back a couple of decades, frankly even further, the share of GDP that is the tax gap, tax error and tax cheating, has been about the same. I mean, it appears from the official data that the amount of cheating and error on tax returns is about the same.

You are never going to get it down to zero, and I also looked at, in my testimony, the information—it is kind of rough—on what happens in European countries. In Europe, the tax gap seemed a little higher than the United States. So I think Americans are generally pretty law-abiding on their taxes.

Senator TILLIS. I was going to ask you about the OECD. I think you answered my next question, but we are in the same ballpark?

Mr. EDWARDS. They are. There are some countries that are lower than us. Both Canada and Britain—they do detailed tax gap analysis like we do, and their gaps are a little lower. But there are a

lot of European countries actually that have higher tax gaps than we do, so we are kind of somewhere in the middle.

Senator TILLIS. Okay.

I was here for the opening statement of the chair, and the IRA and the \$80 billion to the IRS—as somebody who has spent most of my career doing enterprise transformation, here is how I would describe the IRS. They have a lousy customer service record. They understand that problem. They are trying to fix that problem. They have antiquated systems and processes.

And so, I am trying to figure out, and I do think—I voted for the new head of the IRS, because he has background in enterprise transformation. I have to believe that he is looking at this gift of \$80 billion and saying, “Gosh, I wish I could spend it the way an enterprise transformer would spend it.”

One of the things I would not do is spend \$15 million on creating a government alternative to something that is working just fine in the private sector called free filing. There are tens of millions of people currently qualified. If we were going to put that into something that could expand the footprint, that makes more sense.

So, the concern that I have with the IRA, unlike how it has been characterized, is that you are not planning ahead for how you should transform the IRS. You should take a look at the performance indicators that need to be fixed and spend the money that way. Instead, we have said almost double the size of the IRS. It is not going to all be with agents; it is going to be spread out. But there are going to be a significant number of people who are going to be added to an organization that desperately needs to be modernized and to invest in technology.

And in fact, I think if you were to spend every dollar you would spend in artificial intelligence to try and find the cheaters, not the people who made mistakes—we do case work every day in our office for somebody who is dealing with an unpleasant customer experience with the IRS, trying to just fix an error. So let us separate the errors from the cheats, and get every dime you can from the cheats. But I think we are using brute force and labor versus a well-thought-out plan, and I am fully convinced we have leadership that would do it if we allowed him to.

Do you think it makes sense for us to go in and create a competitive product for the private sector on free filings? Mr. Edwards? Anybody who wants to speak.

Mr. EDWARDS. You know, no. The IRS, in the strategic operating plan, has an enormous amount of transformation on their plate that they have got to deal with. It is not just spending more money. There are management reforms, an enormous amount, and like I said, there is a lot of good stuff in the strategic operating plan.

But until they get there, pouring more money into new endeavors does not make any sense. We need a fundamental transformation. I must say, you can fundamentally transform government agencies. I think the current Postmaster General, for example, is actually doing a very good job in transforming the Postal Service, and it has a lot of similar problems as the IRS.

So, we need the transformation first before we go expanding the—

Senator TILLIS. Yes. I wanted to ask questions of the other witnesses. But that is what happens when you do something on a bipartisan basis, versus something on a partisan basis. The Postal Service bill that I supported and worked to get good support for, had 79 votes. Well thought out. This one, not so much.

That is why we need to go back, reopen it, try to—even if you do not change the top-line number, you need to change how it is spent, what the priorities are, if you are really going to have a positive impact on the taxpayers.

Thank you.

Mr. SEPP. I would just quickly add, Senator, that in December of 2022, there was bipartisan legislation being developed by two committee members here, Senator Cardin and Senator Portman, that would have created an Office of Transformation for the Service with better leadership.

The CHAIRMAN. The time of my colleague has expired.

Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman.

Time and again, my colleagues across the aisle have hijacked negotiations to avoid default, in order to extract spending cuts in the name of fiscal responsibility. It seems a little hypocritical for me for congressional Republicans to threaten default and call for spending cuts on the back of working families, when they depleted the revenue side of the ledger over the last 5 years.

Dr. Sarin, how much did the 2017 Republican tax law add to the Federal deficit over 10 years?

Dr. SARIN. Over 10 years, several trillion. It is around \$3 trillion.

Senator MENENDEZ. So that is pretty significant. Now, I am proud I voted for the Inflation Reduction Act, which actually cuts deficit spending, cuts deficit spending while supercharging investments in renewable energy. It also provides resources for the IRS to modernize its IT system, restore customer service, and hire the personnel necessary to collect the taxes that everyone, everyone, including wealthy individuals, legally owes.

So I think that when you give a couple of trillion dollars away, it is a little disingenuous to then say there should be all these spending cuts on the backs of individuals, working families, that will make a difference in our economy.

Over the last 10 years, the IRS budget shrunk by 20 percent, resulting in 20 percent of its workforce being laid off. While middle-class families and small businesses bear the brunt of the IRS customer service problems, wealthy individuals and large corporations are all too happy to take advantage of the IRS's limitations.

Ultimately, that means less revenue to cover the cost of our Federal budget. We are already seeing improvements at the IRS due to the Inflation Reduction Act. Customer service has significantly improved. The IRS is planning to hire the personnel needed to ensure that the wealthiest are paying what they legally owe.

But is the answer to balancing the budget to slash the critical IRS funding and reverse this progress? Mr. Fort, how much does the IRS stand to return to the Treasury over the next 10 years due to tax enforcement of the wealthiest individuals and businesses?

Mr. FORT. Thank you for the question, Senator. You know, I retired from the government a couple of years ago. I do not have

those exact figures. But the return on investment for IRS agents, whether it is on the civil or criminal side, is enormous.

Just the criminal division of the IRS that I worked with for almost 30 years, just over the last several years identified many billions of dollars in tax and other financial fraud.

Senator MENENDEZ. Yes. I have a figure of \$120 billion over 10 years. That is an enormous amount of money. Who pays the price of tax evasion by the wealthiest and large corporations, Mr. Fort?

Mr. FORT. Well, it is all of the American citizens who are abiding by the laws.

Senator MENENDEZ. Now, Dr. Sarin, I have led over eight letters to the IRS about a range of customer service issues. I mean, at the essence, U.S. taxpayers should expect that you will answer the phone, you will answer the mail, you will process returns, at a minimum.

That was not always the case. The IRS consistently now answers the phones, between 80 and 90 percent of the time, at an average speed to answer of 4 minutes, compared to previous times when that was incredibly longer. What would it mean, Dr. Sarin, for taxpayer customer service if my colleagues had their way in rescinding the IRS IRA funding?

Dr. SARIN. Well, Senator Menendez, you would go back to the world as before, where less than 15 percent of calls that were made during filing season were answered, where phone wait times were upwards of 30 minutes, where IRS continued a practice that it called a courtesy disconnect, which essentially knew it was never going to get to you, so it just would cancel your phone call when it received it.

Now the IRS has the tools that it needs to be able to answer customer calls about 90 percent of the time this filing season. It is going to aim for 100 percent of the time and instantaneous communications with taxpayers, and that is what these resources are going to afford it.

Senator MENENDEZ. Yes. Well, I do not think any of my constituents would appreciate a courtesy disconnect at the end of the day.

Finally, it is not just IRS funding that our colleagues want to slash, but other critical government programs to grow jobs and the economy. Last year, Congress appropriated, for example, \$8 billion to the Child Care and Development Block Grants. This helps to provide funding for child-care providers, to support low-income families in accessing child care—to do what, largely? To be able to go to work, to be productive, to contribute to the economy.

Dr. Sarin, what would be the impact on families, child-care providers, and the economy writ large if Republicans insist on slashing vital funding for child care as a precondition to a precedent on the debt default?

Dr. SARIN. Well, we have a whole host of empirical evidence on this question. It means less people able to work, less women able to work. It means worse outcomes for children in the long run, and fundamentally, we do not need to do that to address our debts and deficits. What we can do instead is collect the taxes that are already on the books with actions like the IRA's investment in the IRS.

The CHAIRMAN. I thank my colleague. The next three in order of appearance are Cardin, Bennet, and Warner, and I would say to my colleagues on both sides, we are getting ready to wrap up.

Senator Cardin?

Senator CARDIN. Well, thank you, Mr. Chairman, and I regret I have not been able to be here for the full hearing, but I certainly concur in a lot of the comments that have been made by my colleagues about the impact of the type of cuts that were in the Republican bill.

One of the things that we want to do is have compliance with our tax laws, and the funds that were made available through the Inflation Reduction Act allow us to get a greater compliance on the tax laws that are on the books. I want to mention it though from a little bit different perspective, and that is the fairness to middle-income and lower-income families.

My information shows that we have a higher compliance on the revenues from middle-income families and lower-income families than we do from higher-income families. Secondly, just from the calls to our office, the service levels at the IRS are critically more important to middle-income families in complying with it.

So, if they cannot get a phone call answered, they are going to be much more at risk than higher-income folks who have other alternatives in order to understand their tax liability. So, Dr. Sarin and Mr. Fort, if you could respond from the point of view of the impact it has on different income levels, the fairness of our tax code.

It already is not progressive from the point of view of those who are wealthiest not paying the highest percentages on their taxes, basically because of so many of the loopholes we have and lack of enforcement. But how would the repeal of the IRA funding impact on the fairness to the lower-income and middle-income families?

Dr. SARIN. Thank you so much for the question, Senator Cardin. It is an incredibly important one. The vast majority of your constituents are fully compliant with their tax obligations. Wage and salary earners' taxes are automatically withheld.

For high earners who earn income in opaque ways, things like proprietorship income or rental income, compliance rates are around 50 percent. So what that means is, today we have a two-tiered tax system, where the vast majority of low-income and middle-income people are paying all that they owe, and wealthy tax evaders are getting to skirt the rules because the IRS has no capacity to enforce the laws against them.

That is why the Inflation Reduction Act is so important, because it finally gives the IRS what it needs to be able to go and hire people with expertise in partnerships, who are going to be able to unpack thousands of pages of complex partnership returns; to hire data scientists and economists, who are going to be able to leverage the type of information that comes on offshore bank accounts from the FATCA, and actually deploy it in their enforcement choices and the ways in which they go about making sure that the wealthy play by the same set of rules as everyone else.

Senator CARDIN. That 50 percent is kind of shocking. We know about the trillion-dollar tax gap, right?

Mr. Fort, if you could talk a little bit about the service, the importance of the IRS being able to provide timely information to those that are more modest in income, and the fact that if we do not maintain the funding that we have provided under the Inflation Reduction Act to improve the service levels at the IRS, the impact will adversely impact middle-income and lower-income families.

Mr. FORT. Thanks for the question, Senator, and I completely agree with Dr. Sarin's comments.

The world in which I lived in the IRS for 30 years was all on the criminal side. But I agree completely that the bottom line is, less money means less agents, less service, and less ability to really pinpoint in on where the work and where the resources need to be deployed.

Senator CARDIN. Thank you.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. I thank my colleague. The next Senators have spent a lot of time thinking about these issues.

I am going to call on Senator Bennet and then Senator Warner.

Senator BENNET. Mr. Chairman, if I could go after Senator Warner, I would be happy to defer to Senator Warner.

The CHAIRMAN. In the parlance of the Senate, they are yielding to their friends and all the rest. I am happy to do that.

Senator BENNET. By after, I mean directly after.

The CHAIRMAN. Exactly. There is going to be no question that after Senator Warner will be Senator Bennet.

Senator WARNER. That is extremely gracious, and I will make my question very brief.

I do want to say that I am not really sure that Senator Cardin was here ahead of Senator Bennet and I, but we both have such respect for Senator Cardin. You may know that we let him sit in your chair on the last hearing, and offered the fact that if he would reconsider his decision not to run again, maybe we could work out something on a longer-term basis. I know you rushed back into the hearing after that.

The CHAIRMAN. It all sounds very collegial. I do want to note for the record that Senator Cardin was here first. Thank you.

Senator WARNER. I will be very brief.

Dr. Sarin, it is great to see you. Thank you, thank you, thank you for your work. I do want to clarify, and I hope my Republican staff colleagues will bring this back to the other members. The question of funding IRS and tax savings was hugely bipartisan.

In the Infrastructure gang, there was agreement on using these funds. There was a question and concern that we might come back and double-dip, but there was broad Republican agreement—maybe not at quite the \$80-billion mark, but at least at 40, and I think we could have nudged to 60—that we would have had huge savings.

There was concern that we might come back—and whatever, Build Back Better morphed into IRA—and reuse it again. So, I hope, and I will mention with Senator Tillis—there was a huge understanding on this. And frankly, the CBO estimate of the \$80 billion saving \$120 billion was at the low end of the estimates.

There have been some, including Larry Summers and others, who think that the savings were extraordinarily higher. And I know Senator Menendez already raised this, and I desperately hope that what has been quietly agreed to as a bipartisan initiative does not get slowly chipped away.

I would point out, Mr. Chairman, that if the House approach, if their threat to have our country default were to be taken up, and if they were to exclude a half-dozen entities—now they say they do not want to cut on the domestic side like veterans and others—I believe they would take back all \$80 billion and, on top of that, would potentially cut IRS an additional 30 percent.

So the question, when we have members who say, “I want to make sure my phone call, my constituent’s phone call is returned in a timely manner,” we would take an organization that has already been decimated by cuts and send it right over the precipice.

I just do not get the fact that—I know there is a reluctance from some of my Republican friends to ever look at the revenue side of the house, although all of us who were involved in debt and deficit issues earlier realized we had to do revenues. But the easiest place to do revenues is actually tax enforcement.

Dr. Sarin?

Dr. SARIN. It certainly is, Senator Warner. And I will say that the lack of ability to collect 2 percent of GDP on an annualized basis, that’s \$600 billion that is just sitting there to help us address our fiscal sustainability concerns.

Senator WARNER. And we have had—this tax season came out relatively well. I wish we would have a little more revenue so we have a little more time on the attempts for some to have our Nation default.

But just very briefly, since I said I was not going to take all my time and give back to Senator Bennet, you know, one of the things I have raised in this committee with Commissioner Werfel is to make sure that the Employee Retention Tax Credit—you know, we are seeing some of that process speed up. We have had a lot of Virginia businesses file, and I know there are a lot of Colorado businesses as well.

But if we were to cut back these funds, wouldn’t that just make the problem worse, and are we not—there are a lot of priorities at the IRS. But isn’t the Commissioner starting to knock those down, and isn’t the success rate we have seen recently a sign, a step in the right direction?

Dr. SARIN. Certainly, and he says that they are going to be able to double them now that filing season is over. But I will say, Senator Warner, that the way we got into this situation with small businesses waiting in limbo with the IRS, was precisely because we had a decimated agency that could not do this work, and that is why the IRA is—

Senator WARNER. I am going to ask you to cut off, because Senator Bennet will never be gracious again if I do not stop at this point.

Thank you, Mr. Chairman.

The CHAIRMAN. Well said, Senator Warner.
Senator Bennet?

Senator BENNET. Well said, not about the gracious part but about the——

Just to follow up on your answer to Senator Warner, Dr. Sarin, when you say the \$600 billion is “just sitting there,” what do you mean, it is just sitting there?

Dr. SARIN. What I mean is that today, the difference between the taxes that are owed based on the tax law that is on the books, and what the IRS is able to collect is around \$600 billion a year. Left unaddressed over the course of the next decade, that is going to be \$7.8 trillion that disproportionately comes from a tax evasion benefit to the top 1 percent.

Senator BENNET. And that is what I was going to ask you about. So, if you take—so you are saying that \$600 billion that is owed, it is known that it is owed?

Dr. SARIN. Correct, and that is actually an understatement of true evasion in the economy, because we know that high-income individuals and complex partnerships are able to hide their income even from the audits we use to measure the tax gap.

Senator BENNET. And so, how is that \$600 billion—I mean, can you talk a little, just a little bit about how that is calculated in this sense? You know, are you talking about people who have filed with the IRS and obscured the reality of their tax liability, or are you talking about people who just have never filed with the IRS? Add up that \$600 billion.

Dr. SARIN. Absolutely. So what I am talking about, where the IRS has relatively good measurements of evasion, is with respect to the individual income tax gap, where it does random audit studies and it looks at the difference between what you report, or whether or not you file, and what you actually owed.

But what we know is that the top of the distribution is actually even able to conceal its true income position even from those audits. We know that between 2014 and 2016, 100 of the wealthiest nonfilers, people who did the most blatant kind of evasion, which is not even file their taxes, were responsible for \$10 billion of lost revenue to the fisc.

Senator BENNET. And of the \$600 billion, that is—I mean, that is an annual number?

Dr. SARIN. That is an annual number.

Senator BENNET. So, why is that an annual number? That is something—so every year, there is the gap that you are talking about?

Dr. SARIN. Correct. Each and every year we fail to collect around \$600 billion.

Senator BENNET. And what does that mean to the American people, the tax debt—the other taxpayers who are actually paying what is owed—if it is \$600 billion a year and it is another \$600 billion a year and then another \$600 billion a year?

Dr. SARIN. It creates, and we have not gotten—I am so grateful for the question, because it is an opportunity to comment on the fact that you have a system where, for any new fiscal needs that the government identifies, the only group that bares the costs of those needs is the group of taxpayers that are complying with their tax obligations.

So you have a real competitive distortion in the economy, where certain types of wealthy taxpayers just do not pay what they owe.

Senator BENNET. I am not a—I do not have my calculator with me, but I can tell you, Mr. Chairman, you could pay for a lot of the Child Tax Credit with that \$600 billion.

Dr. SARIN. You certainly could, Senator.

Senator BENNET. If you wanted to.

I, with just the remaining time I have left, I want to thank the chair for holding this meeting, and the reason I want to thank you is that I have talked to families and small businesses all over Colorado, and I have heard that they expect the IRS to work quickly to get Coloradans their returns, which they do not get them, and they expect to have some decent customer support.

The IRS, when we passed the Child Tax Credit, when we passed the Earned Income Tax Credit, the enhancements to those things, that was a lot of work. But people were able to benefit from that, and we were able to do it in real time. I think that is because a lot of us were pushing really hard.

But I think Coloradans and people all over this country deserve a 21st-century tax administrator, one that answers the phone when they call, and that allows them to upload documents electronically, that flags easy to fix errors in their returns.

This sounds like hocus-pocus or magic, but it is the way a lot of other tax systems in the industrialized world work. It is not the way our system works, and that is one of the reasons, frankly, why it is so easy to get away with the kind of tax fraud that you are talking about, the cheating that you are talking about.

The people who are not benefiting from that are working people who are trying to get the benefit of their credit back from the IRS and cannot do it because they have not been able to get their phone calls returned, or because the agency is running software that was written in the 1960s. No offense to the 1960s, but I think we can do better than that.

So I hope for anything else, Mr. Chairman, out of this, that you are able to pull some of the politics out of this issue, that we can put people back to work so they can be responsive to the people we represent, and we can get on to the matters that really are of concern to the American people, which is having a tax code that actually supports working people and their efforts in an economy where, for 50 years, all the benefits have accrued to the people at the very top.

So, thanks for having me, and thanks for having this hearing.

The CHAIRMAN. That sums it up. Thank you.

Senator Cortez Masto?

Senator CORTEZ MASTO. Thank you, Mr. Chairman.

Mr. Fort, I am going to direct this first question to you. The power of the Supreme Court to impact Nevadans' lives every day is clearer than ever before. The *Citizens United* decision in 2010 led to a dark money spending spree, where groups could influence our elections with billions in new spending from the shadows, absent any clear guidance or enforcement. Our elections have become vulnerable to bad actors and foreign interference without sufficient transparency into who is behind these campaigns.

Foreign political contributions are illegal under campaign finance laws. It is extremely difficult to enforce these, since these groups do not disclose information publicly, or to the IRS, about their funding sources. The GAO found that the IRS does not check for illegal foreign money in U.S. elections.

This is why, last Congress, I joined the Spotlight Act with Senators Tester and Wyden, and the DISCLOSE Act with Senator Whitehouse, to increase transparency and disclosure of donors by political special interests and malicious actors. So, Mr. Fort, I guess my question to you is, how does the lack of investment harm the IRS's ability for due diligence, to create better transparency and accountability regarding the influence of dark money groups?

Mr. FORT. Thanks for the question, Senator. So, my entire career was with the criminal side of the IRS, so I did not work on the civil side of the IRS, so I cannot address that part of the question.

I can tell you from a criminal standpoint, that is a type of work that the IRS special agents would be involved in with the Department of Justice and other Federal agencies to address that from a criminal standpoint. And just as a general comment from my experience and background, the years of budget cuts and stagnant budgets mean less application of resources to those type of critical areas that you mentioned.

Senator CORTEZ MASTO. Well, and that is the point, right? We are hearing more budget cuts, right? Already the IRS is underfunded because of all of the cuts. But I hear some of my Republican colleagues continuing to want to cut even the additional resources that we put into the IRS just to catch up, right?

And so, it is going to have a devastating impact on the IRS and its ability to enforce, whether that is civil or criminal; is that correct?

Mr. FORT. Yes. I would agree. They are at a breaking point, and it would be catastrophic at this point.

Senator CORTEZ MASTO. Mr. Sepp, let me ask you this. The National Taxpayer Advocate's annual report to Congress highlights the continuing inability for taxpayers with questions to reach the IRS. While we have seen awesome growth in responses, the IRS is still playing catch-up when it comes to implementing technologies to make customer service more efficient.

Your testimony notes that the IRS must learn to walk before it runs regarding IT. However, this is simply the IRS playing catch-up while technology continues to advance. How can the IRS take a dual approach to improve its cybersecurity while moving forward with its technological advancements?

Mr. SEPP. Well, the addition of a CIO, Senator, to the IRS has been helpful. I have to think that there needs to be closer management of both tracks through something like an IRS Oversight Board. I also think there has to be a new philosophy toward compliance in the electronic sphere. The legislation that you and Senator Blackburn introduced to put parity between mail and electronic communications with the IRS is very important.

It is insane that online filers who owe money do not get the same kind of deference as somebody who throws a check in the mailbox. They automatically become noncompliant if they do not have a cer-

tain number of hours before filing their payment on time. That makes absolutely no sense.

So it is a managerial issue as well as funding issue. The priorities are going to have to be established, especially in the electronic infrastructure. We talk about putting the cart before the horse. We have not really even built the barn yet when it comes to cybersecurity infrastructure. If we are going to go after cybercriminals for revenues, the IRS needs much more robust infrastructure to be able to handle that.

Senator CORTEZ MASTO. Thank you; thank you.

Dr. Sarin, in a 2020 article with Larry Summers and Charles Rossotti, you discuss how unpaid taxes total more than all the individual income taxes paid by the lowest 90 percent of earners. You note that the top 1 percent of earners are responsible for at least 30 percent of the tax gap.

Likewise, in your testimony, you highlighted that if the United States was able to collect the taxes that were already on the books, deficits would shrink by nearly half. We are on the verge of financial catastrophe by defaulting on our debts. It is a conversation that, unfortunately, the Republican Speaker refuses to take off the table.

Per your testimony, the Inflation Reduction Act can help ensure that we reduce the amount of debt that we owe; is that correct?

Dr. SARIN. That is absolutely correct.

Senator CORTEZ MASTO. So, if we repeal the Inflation Reduction Act—which again, Speaker McCarthy and some of the right-wing Republicans in the House want to do—how can we then actually tackle the tax gap?

Dr. SARIN. You cannot, and what happens is that, in the context of a conversation about the debt ceiling and the importance of addressing our deficits, you actually have some who are arguing for a measure that we know will add to the deficit and be a tax cut for the wealthy and large corporations who are evading their fair share.

Senator CORTEZ MASTO. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague. We have Senators, I believe, coming.

I want to ask a question of you, Dr. Sarin, with respect to gift tax audits. Intentionally failing to file a return is a crime, but some very affluent individuals still do not file gift tax returns.

The IRS examined just 95 gift tax returns in 2019. That is an audit rate of about 0.04 percent, 20 times lower than the rate at which the IRS audited returns claiming the Earned Income Tax Credit. Professor Sarin, in your view, what would repealing IRA funding do to the IRS's ability to police gift and estate tax compliance by the very affluent?

Dr. SARIN. Thank you so much for the question, Senator. This came up in, actually, some of my early work on tax administration. The estate tax rate is something like 40 percent. The effective estate tax is around 13.5 percent. There are a lot of tricks people play—some are legal, some are illegal—to avoid their estate and gift tax obligations.

And this should be an area of high focus for the agency going forward, and it is an area where you are absolutely right: capacity is totally depleted. Estate tax and gift tax audit rates are essentially zero today. But a decade ago, they were only 1 percent.

So, it is not like this is an area where the IRS has historically had the capacity to invest. Finally, we are giving them the tools they need and the resources they need and the stability of multiyear funding to actually be able to invest in hiring the type of experts who are going to be able to unpack all of these tricks.

And what that is going to do directly is raise more revenue, but also what it is going to do indirectly is encourage less of the gamesmanship and make sure that people, especially the very wealthiest who are so privileged in this economy, are able to pay their fair share.

The CHAIRMAN. Thank you.

Senator Brown?

Senator BROWN. Mr. Chairman, thank you, and I apologize for—I am having a Banking hearing with the CEOs of Silicon Valley Bank.

The CHAIRMAN. Doing important work.

Senator BROWN. Thank you. I will not keep you long. It will not be the whole 5 minutes.

I recently introduced the FEND Off Fentanyl Act, a bipartisan bill to help prevent increasingly dangerous forms of fentanyl from reaching communities in Oregon and Ohio and elsewhere, by going after it at the source: the transnational criminal organizations and the money launderers who make the profits possible. Stemming the flow of fentanyl is a bipartisan priority. It requires an across-government effort. The IRS Criminal Investigation unit plays an important role in that effort.

Mr. Fort, what would happen to IRS efforts to help stop the flow of fentanyl into our communities if the IRS resources were cut back?

Mr. FORT. Thank you for the question, Senator. A reduction or a cut in the funding would mean less cases, exactly the type of cases you are talking about. They have primary responsibility over tax crimes, but very broad authority in the types of cases you talked about: multiagency narcotics investigations, terrorist financing, things like that. A cut in the budget would put those cases at serious risk.

Senator BROWN. Thank you.

I understand in the case you cited earlier in your testimony, that the payments largely occurred in cryptocurrency. Tell us why the IRS is uniquely positioned to combat crimes happening with cryptocurrency?

Mr. FORT. It is a great question. So what IRS special agents bring to the table is the ability to follow the money. Other Federal agencies have other strengths and do amazing work, but following the money is critical to taking down these types of criminal organizations.

IRS CI has been at the lead and the forefront in investigating crimes around cryptocurrency, back from the days of Silk Road, AlphaBay, BTC-e, Welcome to Video—the list goes on and on. They really have been leading the charge in those investigations.

Senator BROWN. Thank you, Mr. Fort.

Mr. Chairman, thank you, and thanks to all of you.

The CHAIRMAN. Thank you, Senator Brown, for bringing up fentanyl cases in particular. Oregon has been hit very, very hard by these fentanyl criminals. You brought up a case. I asked Mr. Fort about it as well.

These are the real-world consequences of what it means to basically let these McCarthy budgets slash enforcement funding, and I thank you for coming in.

You all have been very patient, and I thank you for it. This has been a very instructive kind of hearing, and if I were to sum it up—I have heard it mentioned by our witnesses; I have heard a Senator or two mention it. Guard rails make common sense, and I can work on those in a bipartisan way.

But make no mistake about it, the first bill that came out of the House was not about guard rails. It was about tossing the additional enforcement money into the trash can. What we have seen is examples today with respect to the real-world kind of benefits in terms of service and fighting tax cheats.

Mr. Edwards, I really noted your comment about the strategic operating plan having good things in it. I think those were exactly your words—and I am going to recognize my colleague from Washington who has been a very strong advocate of defending taxpayers and making sure the service is good.

With just my last comment, we can tackle these issues in a bipartisan way. I wrote two comprehensive tax reform bills, one with Judd Gregg and one with Senator Coats, who sat over there. They incorporated a number of the ideas we are talking about today. In fact, unless my memory fails me, I think, Mr. Edwards, your organization was very helpful, and what we said was, we are going to give everybody in America the chance to get ahead. We are going to be for innovation, we are going to be for fairness, Democrats and Republicans.

We can tackle these issues in a bipartisan way. I do not think we are going to be able to tackle them if we just say we are going to toss all the new enforcement money in the trash can, and a number of you avoided saying that today. I noted it, and I noted your comment, Mr. Edwards, with respect to the benefits of the strategic operating plan.

So, after Senator Cantwell finishes, we will wrap up. But we are interested in talking to all four of you in the days ahead. You have a lot of experience in this area, and we get common ground between people who can have different views.

That is what fixing the tax code is all about, and that is what I have been all about since the years when I had a full head of hair and rugged good looks. So, we will look forward to talking to you.

Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman. I know that there have been many members here asking various questions. I have definitely been asking lots of questions about the backlog at the IRS, and communication.

In the Inflation Reduction Act, actually there are a number of enhancements to customer service, such as improved phone services, self-account services that allow them to interact with the IRS,

manage payments and funds. So, what does anybody think the future of this looks like down the road, when we bring this level of efficiency to the system? I see, Dr. Sarin, you are nodding, so you must know the most about this or have a vision about it.

Dr. SARIN. Well, Senator Cantwell, I think it is an incredibly important question, and I will say a couple of things in response. One is that the type of backlogs that you are speaking to, what happened during the pandemic, the fact that the IRS walked into tax year 2021 with 20 million unprocessed returns, that will never happen again thanks to the Inflation Reduction Act.

It will never happen again because you have given the IRS the tools that it needs to fundamentally digitize its operations, such that it is not people—currently today, it is people hand-transcribing line items from paper returns.

The world of the future is here, and it is here—the IRS is the only organization that functions this way today. We should be able to instantaneously scan and digitize that information so that returns are processed instantaneously, and that is what you have given the IRS the tools to do.

During the pandemic, the IRS answered less than 15 percent of taxpayer calls. This is because it did not have people to put on the phones. Thanks to the Inflation Reduction Act, the IRS does. And you have seen instantaneous changes with respect to something like an 87-percent level of service.

The IRS of the future is going to be an IRS where, just like you communicate with your financial institution, you can deposit checks instantaneously on your phone, you can reach someone in live time. That is the future that the IRS is going to be able to build, now that it has these resources.

And the American taxpayers should be incredibly excited about what it means to be in a country where you have a tax administrator that is in the 21st century.

Senator CANTWELL. What else do we need to do, do you think, to make sure that that happens and stays consistent to that vision that you are articulating?

Dr. SARIN. I think there is a real risk, and it has been unfortunate to observe, over the course of that last several months, calls for rescinding these funds, because rescinding these funds puts the IRS back into the Dark Ages.

What also will put the IRS back into the Dark Ages is if, in the discretionary appropriations process, we don't allow the IRS to use these IRA funds to do this transformative 21st-century building-a-new-IRS work, by making them use their discretionary funds to plug holes in day-to-day operations, if we do not give them what they need in the discretionary process to continue to answer those phones and to continue to pay the workforce that they already have.

Senator CANTWELL. Well, I think also in the information—having worked in software, I mean, one of the things you want to know right away is, what is the most prevailing problem that people have, and then you want to be able to communicate about that.

I would think that that is—you know, in the backlog, in the questions, you could see where there was a sticking point, particu-

larly when there were some changes to the code and you knew that people were going to have a tough time understanding that.

So it just seems like that would also give the IRS the ability to look at what is not being communicated or what some of the problems are and be able to try to address them, or to say this is where all these cases are left, or this is why we are having a backlog, or here is who we are having a backlog with, or it is this segment of the population.

So I am glad that you think that this resource is going to go where we need to go for the future, because I totally agree. The IRS has to be a digital IRS for sure, and this is where we improve service, improve communications, and give people answers.

So, thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague.

What a fitting kind of ending, to make the technology initiative that is in front of the IRS the last subject, and I thank you all.

With respect to the rules of the committee, all members have to get back to us within 1 week by 5 p.m., and thanks to all our witnesses for their patience and professionalism. I thank you.

The Finance Committee is adjourned.

[Whereupon, at 12:15 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF CHRIS EDWARDS, KILTS FAMILY CHAIR
IN FISCAL STUDIES, CATO INSTITUTE

Chairman Wyden, Ranking Member Crapo, and members of the committee, thank you for inviting me to testify at today's hearing, "House Republican Supplemental IRS Funding Cuts."

The Inflation Reduction Act (IRA) included \$79 billion of added funding for the Internal Revenue Service (IRS), which will help to double the agency's budget in nominal dollars between 2023 and 2031.¹ House Republicans would rescind most of the new funding in the recent Limit, Save, Grow Act.

The IRS has been the focus of attention because of its poor taxpayer services and outdated technologies. The agency recently issued a Strategic Operating Plan (SOP) that promised major improvements.²

UNBALANCED FUNDING INCREASE

The Inflation Reduction Act (IRA) included \$79 billion in mandatory spending for the IRS over the coming decade, with \$45.6 billion for enforcement, \$25.3 billion for operations support, \$4.8 billion for business systems modernization (technology), and \$3.2 billion for taxpayer services.

Figure 1 shows the Biden administration's proposed spending increases for the four main budget components of the IRS.³ The figures include the IRA funding plus projected discretionary funding.

Outlays for taxpayer services and business systems are projected to rise for a few years and then fall, while enforcement outlays will grow rapidly and more than triple by 2031. Enforcement spending will rise from 38 percent of the total this year to 61 percent by 2033.

These funding priorities are off kilter. The Biden budget projects business systems outlays to be lower in 2033 than today, yet the needs for new technology will likely remain high. Also, taxpayer services need major improvements: one recent survey ranked the IRS last among 221 private companies and public agencies on customer service.⁴

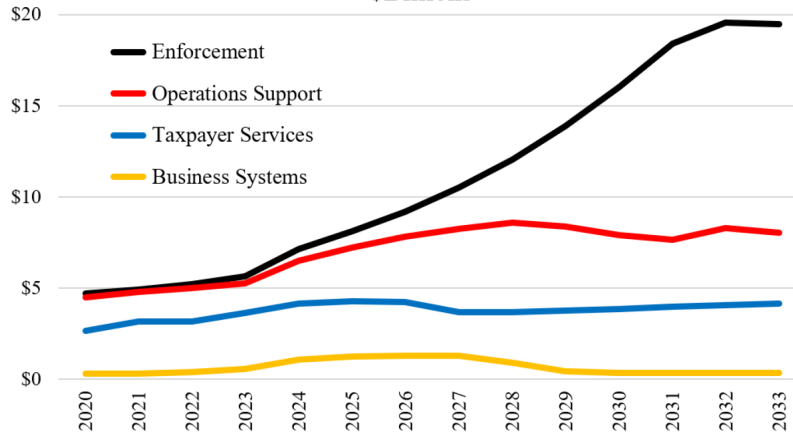
¹*Budget of the U.S. Government, Fiscal Year 2024, Analytical Perspectives* (Washington, DC: Government Publishing Office, 2023), Table 25–1. I am referring to outlays on the budget functions taxpayer services, business systems modernization, operations support, and enforcement, not outlays for refundable credits.

²*Inflation Reduction Act Strategic Operating Plan, FY 2023–2031* (Washington, DC: Internal Revenue Service, 2023).

³*Budget of the U.S. Government, Fiscal Year 2024, Analytical Perspectives* (Washington, DC: Government Publishing Office, 2023), Table 25–1. In addition to these outlays, the IRS has large outlays for refundable credits.

⁴Survey cited in National Taxpayer Advocate, "Objectives Report to Congress, Fiscal Year 2023," p. vii.

1. Biden Administration Projections for IRS Outlays, \$Billions



Source: *Budget of the U.S. Government, Analytical Perspectives*, Table 25-1.

The SOP says that added taxpayer services and technology funding will be needed above the IRA amounts.⁵ It discusses improvements to taxpayer services and business systems over 68 pages of text, but it discusses enforcement over just 17 pages.⁶ Despite this emphasis, enforcement received the lion's share of IRA funding.

Congress should consider rebalancing IRS funding away from enforcement and toward taxpayer services and business systems.

RETURN ON INVESTMENT

The Congressional Budget Office expects the \$79 billion boost to IRS funding to raise \$180 billion over 10 years.⁷ Supporters say this indicates a high "return on investment" from the funding, and thus a beneficial policy change.⁸ But that only considers the government's gain. Instead, policymakers should consider the overall costs and benefits to society.

Consider the costs. They include the \$79 billion for the IRS and possibly higher private-sector compliance costs, which may be about 10 percent of the revenues raised.⁹ Costs may also include dead-weight losses from taxpayers changing their behavior in ways that undermine output, such as reducing work and investment. Increased enforcement can also generate hard-to-quantify costs such as taxpayer anguish, financial uncertainty, and losses of civil liberties.

Now consider the benefits. The government will raise a net \$101 billion for added spending, but that will likely displace private-sector spending. Thus, policymakers need to consider whether the added spending they envision is worth more than the private spending displaced plus the costs of raising the revenue.

Improvements in taxpayer services and business systems could reduce taxpayer costs, increase IRS accuracy, and boost compliance with the law. Thus, the more

⁵ *Inflation Reduction Act Strategic Operating Plan, FY 2023–2031* (Washington, DC: Internal Revenue Service, 2023), p. 129.

⁶ Taxpayer services and business systems are discussed in Objectives 1, 2, and 4, while enforcement is discussed in Objective 3.

⁷ Congressional Budget Office, "Additional Information About Increased Enforcement by the Internal Revenue Service," August 25, 2022.

⁸ For example, see Committee for a Responsible Federal Budget, "CBO Estimates \$120 Billion from IRS Funding Boost," September 2, 2021.

⁹ Rosemary Marcuss, et al., "Income Taxes and Compliance Costs: How Are They Related," *National Tax Journal* 66, no. 4 (December 2013): 833–854. And see Scott Hodge, "The Tax Compliance Costs of IRS Regulations," Tax Foundation, August 23, 2022. The estimates do not include all private-sector costs such as post-filing activities and tax lobbying.

funding going toward these activities, the more likely there will be a win-win for taxpayers and the government. The National Taxpayer Advocate argues that “the most efficient way to improve compliance is by encouraging and helping taxpayers to do the right thing on the front end. That is much cheaper and more effective than trying to audit our way out of the tax gap one taxpayer at a time on the back end.”¹⁰

By contrast, more aggressive IRS enforcement would increase taxpayer costs, as they would invest more time and energy defending themselves. The IRS would catch some additional tax cheats, but law-abiding taxpayers would face collateral damage.

Collateral damage would result because the IRS makes many errors, which is not surprising given the complexity of the tax code. The issues at dispute are often gray, as illustrated by litigation statistics, which show that the IRS wins only about half the time.¹¹ For Tax Court and refund cases closed over the past 5 years, the IRS on decision gained just 48 percent of the dollars in dispute.

Similarly, IRS auditing imposes collateral damage because many audited taxpayers have paid the correct amount. For example, between 40 to 50 percent of partnership audits result in no recommended changes.¹² For individuals earning more than \$5 million, the audit no-change rate is just under 40 percent.¹³ Given that audits are often targeted by IRS algorithms and discrepancies, these percentages seem quite high. Recommended changes can be wrong and may be appealed. Tax litigation expert Daniel Pilla believes that more than half of IRS audit results are incorrect.¹⁴

The IRS and the Biden administration promise to focus increased enforcement on high-earning households. Interestingly, IRS data show that tax recommended on audits is higher relative to income for middle-income returns than for high-income returns. For audits with recommended changes, the changes average roughly 5 to 8 percent of income for middle-income taxpayers but just 1 to 3 percent of income for high earners.¹⁵ High-earning taxpayers are more likely to receive expert tax advice, and thus less likely to make errors.

Of course, the IRS needs to enforce the tax laws, as enforcement deters cheating. But there are downsides to increased enforcement, including higher compliance costs, higher dead-weight losses, and added stress and uncertainty for families and businesses. With more aggressive enforcement, taxpayers who are already paying the correct amount will need to expend time and energy defending themselves. And because the IRS is such a powerful agency, aggressive tax enforcement can put civil liberties at risk.¹⁶

FEDERAL TAX GAP STABLE

Last year, the IRS released a new estimate of the “tax gap,” which is the amount of Federal taxes owed but not paid.¹⁷ The average gross tax gap for 2014–2016 was \$496 billion, and after late payments and enforcement the net gap was \$428 billion. The report includes tax gap estimates for prior years and a projection for 2017–2019.

The dollar value of the tax gap has increased over time, but the gap has not increased when compared to the Nation’s gross domestic product (GDP), as shown in

¹⁰ National Taxpayer Advocate, “IRS Strategic Operating Plan Has Potential to Transform Tax Administration,” NTA Blog, April 6, 2023.

¹¹ *Internal Revenue Service, Data Book 2022* (Washington, DC: Internal Revenue Service, 2023), Table 29. I’ve included Tax Court and refund cases, 2018 to 2022.

¹² *Internal Revenue Service, Data Book 2022* (Washington, DC: Internal Revenue Service, 2023), Table 17. The no-change rate is 40 to 50 percent based on closed audits for 2012 to 2017.

¹³ Government Accountability Office, “Tax Compliance: Trends of IRS Audit Rates and Results for Individual Taxpayers by Income,” GAO–22–104960, May 2022, Figure 4. The GAO no-change estimates are higher than figures in the IRS *Data Book* for reasons the GAO discusses.

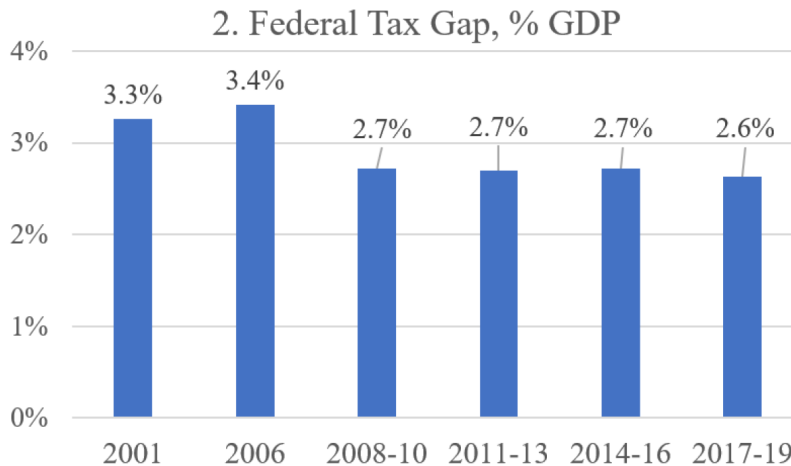
¹⁴ Daniel Pilla argues, “IRS’s audit results are incorrect between 60 and 90 percent of the time,” which he says stems from relatively few taxpayers challenging them. Daniel Pilla, “Three False Narratives Being Used in the IRS Funding Push,” *National Review*, May 17, 2021.

¹⁵ Government Accountability Office, “Tax Compliance: Trends of IRS Audit Rates and Results for Individual Taxpayers by Income,” GAO–22–104960, May 2022. Author calculations based on Tables 1 and 4. I roughly estimated income within each group to calculate the ratios. You can see the same pattern in the IRS *Data Book* Table 17.

¹⁶ Civil liberties issues are summarized in Joseph Bishop-Henchman, “Transforming the Internal Revenue Service,” Cato Institute, April 11, 2023.

¹⁷ *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014–2016* (Washington, DC: Internal Revenue Service, August 2022).

Figure 2.¹⁸ Despite the decline in audit rates, the tax gap dipped from 3.3 percent of GDP 2 decades ago to 2.6 percent more recently. The degree to which Americans are law-abiding on Federal taxes does not appear to have changed much over time.



Source: Author calculations based on Internal Revenue Service estimates.

U.S. AND FOREIGN TAX GAPS

International studies show that the U.S. tax gap is not high compared to other advanced economies. Our Federal tax gap is 2.6 percent of GDP, and if we assume the same nonpayment rate for State-local taxes, the overall U.S. tax gap is about 4.0 percent of GDP.¹⁹ That figure may be compared to other countries.

- In a 2018 study, Konrad Raczkowski and Bogdan Mróz estimated that the tax gap for the United States was 3.8 percent of GDP and the gap for 28 European Union (EU) countries was 7.7 percent of GDP.²⁰
- In a 2015 study, Konrad Raczkowski estimated that the tax gap for 28 EU countries was 10.7 percent of GDP.²¹
- In a 2019 study, Richard Murphy estimated that the tax gap for 28 EU countries was 5.6 percent of GDP.²²

However, the overall EU tax burden is higher than the U.S. burden. If we adjust the EU gap estimates down using the ratio of U.S. to EU taxes, the EU gap estimates are 5.1 percent for Raczkowski-Mróz, 7.1 percent for Raczkowski, and 3.7 percent for Murphy.²³ These figures are still similar or higher than the U.S. gap. However, there are a few advanced economies that have published detailed gap estimates that are lower than the U.S. gap.²⁴

The above bulleted studies are based on measures of shadow economies, which generally means otherwise legal activities that escape taxation. Here are two further studies:

¹⁸ I used the GDP of the middle year for the multiyear estimates.

¹⁹ I estimated State-local tax gaps based on the ratio of total State-local to Federal tax revenues of 0.52 to 1.0 over the past 3 years.

²⁰ Konrad Raczkowski and Bogdan Mróz, "Tax Gap in the Global Economy," *Journal of Money Laundering Control* 21, no. 4 (December 2018): 545–554.

²¹ Konrad Raczkowski, "Measuring the Tax Gap in the European Economy," *Journal of Economics and Management* 21, no. 3 (October 2015): 58–72.

²² Richard Murphy, "The European Tax Gap: A Report for the Socialists and Democrats Group in the European Parliament," *Tax Research UK*, January 23, 2019.

²³ The ratio of U.S. taxes-to-GDP to EU taxes-to-GDP is about 0.66.

²⁴ For example, see Canada Revenue Agency, "Overall Federal Tax Gap Report," 2021. And see HM Revenue and Customs, "Measuring tax gaps 2022 edition: Tax gap estimates for 2020 to 2021," June 23, 2022.

- In a 2018 study across 158 countries, Leandro Medina and Friedrich Schneider found that the U.S. shadow economy is the second smallest as a percent of GDP.²⁵ From 2010 to 2015, the U.S. shadow economy of 7.7 percent compared to the European average of 20.2 percent.
- In a 2016 study across 157 countries, Mai Hassan and Friedrich Schneider estimated that the U.S. shadow economy was 8.3 percent of GDP in 2013 and the EU's was 23.1 percent.²⁶

These sorts of estimates should be considered rough. Also, they overstate revenues that might be gained from enforcement if they do not account for behavioral responses.²⁷ For example, if the IRS were to squeeze more money from businesses, some would cut hiring and investment, which would reduce the revenues raised.

BETTER WAYS TO BOOST TAX COMPLIANCE

The IRA boosted enforcement spending to improve compliance, but there are three better ways to boost compliance that would benefit taxpayers and the economy.

First, keeping taxes low to reduce incentives for cheating. Discussing international studies, Hassan and Schneider note, “It is widely accepted in the literature that the most important cause leading to the proliferation of the shadow economy is the tax burden. The higher the overall tax burden, the stronger are the incentives to operate informally in The higher the overall tax burden, the stronger are the incentives to operate informally in order to avoid paying the taxes.”²⁸

Second, improving taxpayer services, technologies, and employee training at the IRS, which would reduce filing and audit errors. The National Taxpayer Advocate said, “Tax compliance depends on prompt, high-quality customer service, and when compliance becomes unduly burdensome, the IRS runs the risk that taxpayers will simply quit trying.”²⁹

Third, simplifying the tax code. Rising complexity is an invitation for errors and abuse. In a 2022 report on IRS audits, the Government Accountability Office found, “Since fiscal year 2010, average audit hours have more than doubled for returns with income of \$200,000 and above.”³⁰ That statistic likely reflects the rising complexity of the code.

In 2012, the National Taxpayer Advocate said that tax code complexity “facilitates tax avoidance by enabling sophisticated taxpayers to reduce their tax liabilities and by providing criminals with opportunities to commit tax fraud.”³¹ She concluded that tax reforms to simplify the code would “reduce the likelihood that sophisticated taxpayers can exploit arcane provisions to avoid paying their fair share of tax; enable taxpayers to understand how their tax liabilities are computed and prepare their own returns; improve taxpayer morale and tax compliance.”³²

Unfortunately, Congress has not heeded the NTA’s advice. The IRA, for example, added 20 or so new and expanded energy tax breaks, many with complicated rules. The SOP says the energy provisions will cost \$3.9 billion to administer, and they will surely generate enforcement problems. The new breaks will also boost costs for

²⁵ Leandro Medina and Friedrich Schneider, “Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?”, IMF Working Paper, January 2018.

²⁶ Mai Hassan and Friedrich Schneider, “Size and Development of the Shadow Economies of 157 Countries Worldwide: Updated and New Measures from 1999 to 2013,” Institute for the Study of Labor (IZA, Germany), October 2016. I calculated the average of 28 EU nations from their appendix.

²⁷ Norman Gemmell and John Hasseldine, “The Tax Gap: A Methodological Review,” *Advances in Taxation* 20 (December 2012): 203–231.

²⁸ Mai Hassan and Friedrich Schneider, “Size and Development of the Shadow Economies of 157 Countries Worldwide: Updated and New Measures from 1999 to 2013,” Institute for the Study of Labor (IZA, Germany), October 2016.

²⁹ National Taxpayer Advocate, “Hello, Is Anyone There? Taxpayers and Practitioners Continue to Experience Frustration Over Lack of Adequate Phone Service,” NTA Blog, February 8, 2023.

³⁰ Government Accountability Office, “Tax Compliance: Trends of IRS Audit Rates and Results for Individual Taxpayers by Income,” GAO-22-104960, May 2022, p. 14.

³¹ Taxpayer Advocate Service, “2012 Annual Report to Congress: Volume 1,” December 31, 2012, p. 3.

³² Taxpayer Advocate Service, “2012 Annual Report to Congress: Volume 1,” December 31, 2012, p. 22.

planning, compliance, and lobbying in the private sector since \$1 trillion in benefits are at stake.³³

The number of official tax expenditures has risen from 53 in 1970 to 205 today, making the IRS's administration and enforcement job ever more difficult.³⁴ We know from experience that complex tax expenditures, such as the Low-Income Housing Tax Credit, generate substantial errors and abuse.³⁵ So tax simplification to eliminate special breaks would reduce the tax gap and reduce IRS costs for administration and enforcement.

CONCLUSIONS

IRS estimates show that the tax gap is not rising relative to the size of the economy, and the U.S. tax gap appears to be modest by international standards. Nonetheless, policymakers can reduce the tax gap by reducing tax rates, improving IRS services and efficiencies, and simplifying the tax code. Those policies would be a win for taxpayers, the government, and the economy.

The National Taxpayer Advocate recently argued that IRA funding "is disproportionately allocated for enforcement activities, and I believe Congress should reallocate IRS funding to achieve a better balance with taxpayer service needs and IT modernization."³⁶ That seems right, and so a compromise between House and Senate may be to shift some of the enforcement increases to taxpayer services and business systems.

Thank you for holding this important hearing.

PREPARED STATEMENT OF JOHN D. FORT, DIRECTOR OF INVESTIGATIONS, KOSTELANETZ, LLP; AND FORMER CHIEF, CRIMINAL INVESTIGATION, INTERNAL REVENUE SERVICE

Chairman Wyden, Ranking Member Crapo, and members of the committee, thank you for the opportunity to discuss the need for consistent funding for the Internal Revenue Service (IRS) to address both critical service updates for the taxpayer experience and sufficient support for enforcement activities. As the former Chief of Criminal Investigation (CI) for the IRS, I have witnessed firsthand the important role that enforcement plays in promoting voluntary compliance with the Nation's tax laws. But enforcement does not operate in a vacuum within the IRS and the appropriate mix in funding enforcement, technology, and taxpayer service initiatives is the key to building an IRS that is both responsive and efficient.

The IRS is the backbone of the Nation's tax system- it ensures the collection of taxes that fund our essential government programs and services. It is responsible for managing a budget of more than \$11 billion, which goes toward processing tax returns, enforcing compliance, and providing essential services to taxpayers. Underfunding the agency means putting the accuracy and efficacy of our tax system at risk.

We have all heard the stories of the IRS using 60-year-old technology. While I know improvements in many areas have been made where possible, it is impossible to modernize an antiquated system and develop a range of new technologies to improve tax administration while executing filing seasons with a budget that does not allow for such improvements. The IRS needs advanced communication channels that allow taxpayers to reach the IRS quickly and efficiently through various means. Upgrades are necessary to automate many of its procedures and increase the speed of their tax processing procedures. Taxpayers should be able to interact with the IRS in many of the same ways that they interact with their financial institutions. Such automated and digital upgrading cannot happen without constant and regular funding of the IRS.

³³ Penn-Wharton Budget Model, "Update: Budgetary Cost of Climate and Energy Provisions in the Inflation Reduction Act," April 27, 2023.

³⁴ Author counts based on Joint Committee on Taxation, "Estimates of Federal Tax Expenditures," JCS-22-22, December 22, 2022, and Joint Committee on Taxation, "Estimates of Federal Tax Expenditures," JCS-28-72, October 4, 1972.

³⁵ Chris Edwards and Vanessa Brown Calder, "Low-Income Housing Tax Credit: Costly, Complex, and Corruption-Prone," Cato Institute, November 13, 2017.

³⁶ National Taxpayer Advocate, "IRS Strategic Operating Plan Has Potential to Transform Tax Administration," NTA Blog, April 6, 2023.

During my almost 30 years with the IRS, it was embarrassing to me as an employee that my elderly parents, in-laws, relatives, friends, and neighbors couldn't pick up the phone and call the IRS with a question, or better yet, manage their account online. It was not for a lack of effort by the IRS, but the years of budget cuts caused the service to make impossible choices to keep the lights on in certain areas. It appears that we are heading in that direction, albeit 30 years later than needed with the passage of the Inflation Reduction Act (IRA). As the organization responsible for collecting 98 percent of the revenue for this country, trusting the public to figure out exactly what their tax obligation is seems contrary to me. It also seems contrary to me to starve the agency for so many years rather than try to facilitate these interactions with the public.

Another critical concern is the implementation of recent tax law changes. Some of these changes impose new regulatory and reporting requirements on taxpayers, including many exclusively for the ultra-wealthy; however, the real problem is the lack of expertise in the IRS staff relevant to new tax provisions. Acquiring and processing all this information will necessitate a massive amount of time and resources. Positioning a well-trained, diverse staff equipped with the latest modern technological changes is crucial to address these tax law changes. The IRS does not have the staff to accomplish this goal and they do not have the capacity to hire staff quickly enough to make changes from year to year. Nothing short of a complete overhaul to the way the IRS hires and trains their employees will make the changes needed to implement these important upgrades. But like any large organization, these changes have impacts on the entire organization. If the civil side of the IRS is going to ramp up the hiring of staff to be able to work more complex civil audits and produce more complex programs to aide in the efficiency of filing tax returns, similar investments will need to be made on the criminal side. CI will only be able to handle complex referrals to work complex cases if the investments in enforcement are on both sides. Currently, CI reports that only 6 percent of their inventory comes from civil referrals. This is a missed opportunity and the result of a lack of investment in all areas of enforcement for many years. It is important to remember that in a properly functioning tax administration system, the civil and criminal functions work closely together to align their goals and program areas.

When most of the public thinks of the IRS, they think of filing their taxes and potentially getting audited. Taxpayer service and civil enforcement cannot exist on their own without similar, consistent funding for both areas. This funding is essential to ensure that taxpayers can receive the assistance they need from the agency to file their returns and resolve their disputes while knowing that audits conducted by the agency are fair and efficient. The decades of funding battles for the IRS have left the service in a place where achieving this result for the American public is not possible without a significant infusion of money over and above what the annual budget provides to the IRS.

It will take far more, however, than a dramatic one-time infusion of money to cure what ails the Nation's revenue arm. Between 2010 and 2019, according to the IRS Data Book, the agency's budget dropped from \$14.6 billion to \$11.5 billion, and its workforce dropped from approximately 94,000 employees to 73,000—all while the economy roared on and generated enormous wealth. Starving the IRS of funding was shortsighted, hurting the entire country.

The voluntary compliance rate is estimated to be roughly 84 percent, and every 1 percentage point in this level of compliance costs the U.S. approximately \$40 billion dollars. When individuals or corporations skirt their tax obligations, they do so on the backs of their fellow Americans: They pay less, while the rest of us pay more.

One of the areas that the IRA purports to help the service accelerate is their use of data analytics. With so many analytic tools available to comb through the endless amounts of data, not taking advantage of them would be foolish. There is likely no other agency in the world with as much rich data as the IRS, so the need to manage that data in a useful way could be the single most important thing the IRS needs to focus on.

Data analytics is a very broad and often overused term. In the context of tax administration, it has the potential to be the "secret sauce" that allows the IRS to maximize the deployment of their human resources. In my opinion, the investment in data analytics needs to bring the analytics as close to the filing of the tax return as possible. If errors and anomalies are detected or mismatches occur when the return is filed—not just in identity theft—then the potential exists for these issues to be resolved without the IRS having to invest costly human resources to conduct an audit or investigation.

The investment in data analytics pays dividends on the criminal side as well. While the Nationally Coordinated Investigations Unit (NCIU) began using complex models to build case leads several years ago while I was Chief, that model could supersize case development with the right investment from IRA money. This could reduce the amount of cases that are closed without action, increase the complexity of cases that are selected, and ultimately increase tax compliance by showing the public that illegal tax and other financial crimes are not a profitable business and that there are serious repercussions for non-compliance.

As mentioned, I spent my career with the Criminal Investigation Division within the IRS—the only agency with the authority to investigate and recommend prosecution for violations of the tax code. CI forms the backbone of the voluntary compliance regime that our tax system depends on. Let me say that again—CI is the only agency in our government allowed to investigate and recommend prosecution of Federal tax crimes. The fact that you can be incarcerated for committing felony tax crimes in the United States provides a strong deterrent to those looking to take an unfair advantage over their neighbors and business competitors. Without sustained funding for rigorous enforcement, the system of voluntary compliance will continue to erode.

While what follows is a glowing report of the successes of CI, what this testimony does not include is all of the criminals CI did not investigate due to a lack of resources over the years. Commonly referred to as the “best financial investigators in the world,” CI does not have the investigative capacity to work all the investigations that demand attention by the IRS and DOJ. CI could spend 100 percent of their time on any one program area and still not root out all crime in that program area. Trying to pick the most impactful cases that will create deterrence in each program area in each neighborhood in America has been the formula for success for many years. And while CI has achieved incredible results with a diminishing budget for years now, the amount of money left on the table by not investigating various egregious crimes where resources were not available is unfortunate and not fair to those of us that pay our fair share. IRA money is expected to close this gap for CI just as it will in other areas for the rest of the service.

CI’s services are in high demand by both the Department of Justice (DOJ) and by U.S. Attorney Offices around the country. There simply are not enough resources to work the priorities of the DOJ and the IRS alike. If you took a survey of the U.S. Attorney’s Offices, you would quickly learn the immeasurable value that the men and women of IRS–CI bring to all their investigations. Prosecutors want the best financial investigators on all their cases and sometimes compromises must be made to ensure CI works those cases that have the biggest impact on the most people. Why should we have to compromise on significant tax and financial crime cases? Why should the world and our financial systems be less safe because we are not investing in the right places? This seems like an unnecessary choice to me.

When difficult choices are made involving case selection and strong, righteous cases are not worked due to resource issues, the loser is the American public. Every major law enforcement agency brings their strengths to the table—CI’s strengths are investigating financial crimes, often complex financial crimes. IRS–CI devotes 100 percent of their resources to investigating financial crimes. Virtually every alleged Federal crime involves greed, and where there is greed there is money. Following the money is what CI does best, and that is backed up with a 92-percent conviction rate, believed to be one of the highest in Federal law enforcement. Like the rest of the IRS, CI understands the important role of oversight. They welcome that oversight as no one should expect a blank check without showing a return on the investment from the American taxpayer. This produces trust in the agency and is vital in today’s world.

In a system where resources are not without end, deterrence must play a significant role in enforcement. IRS–CI endeavors to maximize publicity of CI prosecutions to provide a strong deterrent message to would-be tax evaders and those who commit other financial crimes. This helps ensure integrity and fairness in the tax system. This is a fundamental premise to all prosecuted Federal financial crimes. There are not enough resources to investigate the way out of the problem, so publicity and deterrence plays a key role. The IRS’s relevance with regards to tax enforcement relies heavily on the ability of CI to investigate and recommend prosecution of criminal tax violations to DOJ. While tax violations are the bread and butter of the agency, CI investigates and plays a critical role in much more than just tax violations. When Congress authorized Bank Secrecy Act and Money Laundering jurisdictions for the agency more than 50 years ago, it was because Congress recog-

nized the importance of addressing these crimes required the skills and expertise of IRS-CI to help “follow the money.” For the last 50 years, there has been no agency better at following the money than IRS-CI and the role of IRS-CI has assisted in taking many dangerous organizations off the streets and has made Americans safer and our financial systems safer and more secure.

Dr. Jeffrey A. Dubin is cofounder and partner in Pacific Economics Group and a tenured professor of economics at the California Institute of Technology. He has spent his career analyzing microeconomic modeling with an emphasis on discrete-choice econometrics. His research includes the effect of enforcement and publicity on the deterrence of future crimes. In 2007, his research found that “CI activities have a measurable and significant effect on voluntary compliance. Second, it concludes that the mix of sentenced cases (for tax and money laundering violations) is not a significant determinant of tax compliance. Third, it finds that incarceration and probation (rather than fines) have the most influence on taxpayers. . . . Doubling CI tax and money laundering sentences is forecast to increase assessed collections by \$16.0 billion. It estimates the general deterrence or spillover effects from either audit or CI activities to be approximately 95 percent.”

PROGRAM AREAS

What follows is a small example of the types of cases in which CI has led or has been significantly involved in over the last few years. These cases show the breadth and skill of CI’s Special Agents in various types of fraud and criminal activity that have had significant impacts on the financial system at home and overseas. Despite being underfunded for many years, CI has consistently outperformed expectations. Increased funding to CI would obviously mean an increase in impactful cases/investigations. This increase in CI’s pipeline would mean more criminals are held accountable, more deterrence to committing these crimes is created, and the domestic and global financial system is protected from the flow of illicit funds.

It should also be noted that most of these cases were worked in a multiagency environment, with DOJ, one or more Federal agencies and often with one or more private industry partners. The use of multi-agency investigations is a force multiplier in complex Federal investigations. Reduced funding for IRS-CI means reduced effectiveness for Federal multiagency investigations. Taking away one critical Federal agency, such as IRS-CI is akin to losing a link in a chain. This means fewer or less effective investigations of narcotic traffickers, child exploiters, terrorist financing organizations, Ponzi schemes, sanctions investigations and all other investigations that utilize this proven recipe for success.

Tax Investigations

IRS-CI is the only Federal law enforcement agency authorized to investigate title 26 (Federal criminal tax) violations. Priority areas include abusive tax schemes, employment tax fraud, non-filers, questionable refund program, international tax enforcement, abusive return preparers, identity theft and many others. Crossover between tax and non-tax crimes is common and the effective utilization of multiagency investigations is utilized in many Federal tax investigations.

Wealthy taxpayers have historically been able to shield themselves from the scrutiny of the tax authorities through complicated, but legal tax strategies. So, it stands to reason that to tackle this disparity in compliance rates, the IRS should consider a more equitable allocation of enforcement resources by addressing tax scams and other illegal activities that benefit the rich without targeting low- and middle-income earners. IRA funding should bridge this gap and allow CI to use data analytics, increased staffing, and better coordination with civil partners to find the most egregious tax cases to work.

Case examples include:

Kingston Investigation—3/16/2020

<https://www.irs.gov/compliance/criminal-investigation/jury-finds-los-angeles-businessman-guilty-in-1-billion-biodiesel-tax-fraud-scheme>

- Washakie Renewable Energy (WRE) was a company owned by Jacob and Isaiah Kingston and located in Utah. WRE made false claims for fuel excise tax credits exceeding \$1.1 billion.
- Lev Dermen sentenced to 40 years and Jacob Kingston sentenced to 18 years among others.

Brockman Investigation—10/15/2020

<https://www.justice.gov/opa/pr/ceo-multibillion-dollar-software-company-indicted-decades-long-tax-evasion-and-wire-fraud>

- Robert Brockman, the CEO of an Ohio-based software company, was indicted with tax evasion, wire fraud, money laundering, and other offenses. The charges stem from a decades-long scheme to conceal approximately \$2 billion in income from the IRS as well as a scheme to defraud investors in the software company's debt securities.
- Brockman passed away before he could face trial.

Antonieta Mena—6/24/21 (10 years); Melanie Wilhelm—8/13/2021 (27 months)

<https://www.justice.gov/usao-sdfl/pr/owner-immigration-business-pleads-guilty-defrauding-uscis-and-irs>

- Subjects conspired to steal approximately \$1.8 million from the Treasury by directing fraudulently obtained tax refund checks through an attorney client/trust accounts.
- Refund checks were issued based on false tax returns using stolen identities from target immigration business and proceeds were used to purchase about a dozen investment properties and support subject's lifestyle.

Singapore Solution—9/28/2021

<https://www.justice.gov/opa/pr/indictment-unsealed-against-six-individuals-and-foreign-financial-service-firm-tax-evasion>

- Six people offshore financial service executives and a Swiss financial services company were charged with conspiracy to defraud the IRS by helping three large-value U.S. taxpayer clients conceal more than \$60 million in income and assets held in undeclared, offshore bank accounts and to evade U.S. income taxes.

Credit Suisse—5/2014

<https://www.justice.gov/opa/pr/credit-suisse-pleads-guilty-conspiracy-aid-and-assist-us-taxpayers-filing-false-returns>

- Bank admitted to helping U.S. taxpayers hide offshore accounts from IRS and agreed to pay \$2.6 billion, the highest ever payment in a criminal tax case investigation; also led to indictment of eight Credit Suisse employees since 2011.
- The plea agreement, along with agreements made with State and Federal partners, provided that Credit Suisse would pay a total of \$2.6 billion—\$1.8 billion to the Department of Justice for the U.S. Treasury, \$100 million to the Federal Reserve, and \$715 million to the New York State Department of Financial Services.

Narcotics/Counterterrorism/National Security Investigations

IRS-CI targets the illicit financial flows of Transnational Criminal Organizations to reduce the economic incentive of narcotics trafficking, terrorist financing, and money laundering. IRS-CI has key positions and is an equal partner with sister Federal agencies to enhance operational coordination with a variety of agencies to include the Drug Enforcement Agency (DEA), the Organized Crime Drug Enforcement Task Force (OCDETF) Fusion Center, FinCEN, the High Intensity Drug Trafficking Areas (HIDTA), Joint Terrorism Task Force (JTTF), and National Counterintelligence Task Force (NCITF) to name a few. Investigations involve money laundering (title 18) and currency violations (title 31). IRS-CI is the largest user of Bank Secrecy Act data to identify significant financial criminal activity. IRS-CI recently released data showing that over the past 3 fiscal years, more than 83 percent of IRS-CI criminal investigations recommended for prosecution had a primary subject with a related BSA filing. Convictions in those cases resulted in average prison sentences of 38 months, \$7.7 billion in asset seizures, \$256 million in restitution, and \$225 million in asset forfeitures. Approximately 15.8 percent of all IRS-CI investigations opened during FY 2022 originated from a BSA form. Investigative areas from this data include money laundering, narcotics, public corruption, corporate fraud, terrorism, health-care fraud, and financial institution fraud.

Case examples include:

Operation SpecTor—5/2/23

<https://www.justice.gov/opa/pr/largest-international-operation-against-darknet-trafficking-fentanyl-and-opioids-results>

- Operation SpecTor was a coordinated international effort that spanned three continents to disrupt dark web fentanyl and opioid trafficking. Operation SpecTor is a Joint Criminal Opioid and Darknet Enforcement (JCDOE) operation targeting darknet trafficking of fentanyl and opioids.
- The operation resulted in 288 arrests—the most ever for any JCDOE operation and nearly double that of the prior operation. Law enforcement con-

ducted more seizures than any prior JCODE operation, which included 117 firearms, 850 kilograms of drugs, including 64 kilograms of fentanyl or fentanyl-laced narcotics and \$53.4 million in cash and virtual currency.

El Chapo—2/12/19

<https://www.justice.gov/opa/pr/joaquin-el-chapo-guzman-sinaloa-cartel-leader-convicted-running-continuing-criminal>

- Joaquín Archivaldo Guzmán Loera, known by various aliases, including “El Chapo” and “El Rapido,” was convicted of being a principal operator of a continuing criminal enterprise—the Mexican organized crime syndicate known as the Sinaloa Cartel—a charge that includes 26 drug-related violations and one murder conspiracy.
- Guzmán Loera was convicted of all 10 counts of a superseding indictment, including narcotics trafficking, using a firearm in furtherance of his drug crimes and participating in a money laundering conspiracy.

El Chapitos—4/14/23

<https://www.irs.gov/compliance/criminal-investigation/four-of-chapos-sons-indicted-for-large-scale-drug-trafficking-money-laundering-and-violent-crimes-as-alleged-leaders-of-sinaloa-cartel>

- El Chapitos, El Chapo’s four children, who led the Sinaloa cartel along with Mayo and Dámaso López Nuñez, coordinated the cartel’s drug trafficking activities with other members and associates of the cartel to import large quantities cocaine from Central/South American countries into Mexico and then further distribute the cocaine as well as heroin, methamphetamine, and marijuana into the United States, including the Chicago area, and other areas abroad.

Vasquez-Hernandez—11/24/14

<https://www.justice.gov/usao-ndil/pr/sinaloa-cartel-member-sentenced-22-years-federal-prison-plea-agreements-unsealed>

- Alfredo Vasquez-Hernandez, 59, was sentenced to 22 years in prison for his role in a \$1-billion trafficking conspiracy.
- Vasquez-Hernandez was a high-ranking member of the Sinaloa cartel and a close lieutenant of Joaquín “El Chapo” Guzmán.
- Hernandez was the logistics man behind shipping tons of drugs by train from Mexico to Chicago concealed amid furniture cargo.

Aguirre—12/03/21

<https://www.irs.gov/compliance/criminal-investigation/sinaloa-cartel-leader-convicted>

- Herman Aguirre, the leader of transnational drug conspiracy tied to the El Chapo Mexican drug cartel, was convicted of narcotics conspiracy, and operating a continuing criminal enterprise and money laundering conspiracy. He was sentenced to serve life in prison.
- Aguirre was the leader of a transnational drug trafficking organization that utilized contacts and a source of supply whose territory included Mexico, Arizona, California, and elsewhere. The source of supply was the Sinaloa Cartel, led by Joaquín “El Chapo” Guzmán and Ismael “El Mayo” Zambada.

KLEPTOCRACY

Current investigations involving Russian oligarchs, corrupt politicians, and those who facilitate the illicit movement of money on behalf of sanctioned individuals or organizations are a priority for all law enforcement and CI is an active participant in the Kleptocapture Taskforce by DOJ and joined the task force at its inception. IRS-CI investigators are not only experts in tracing assets and understanding the complex global financial world, but they also work seamlessly with law enforcement partners across the globe to ensure the integrity of the U.S. financial system on behalf of U.S. taxpayers. Just last week, IRS-CI made news by training three Ukrainian law enforcement agencies with the help of private-sector partners in crypto and cyber tools. IRS-CI’s asset seizure and forfeiture program utilizes seizure and forfeiture authority as an investigative tool to disrupt and dismantle criminal enterprises. The program seeks to deprive criminals of property used in or acquired through illegal activities.

IRS-CI has active investigations involving Russian oligarchs, corrupt politicians, and those who facilitate the illicit movement of money on behalf of sanctioned individuals or organizations. When a foreign corrupt government official receives bribes, they will many times use a third party to move, or launder, those illegal proceeds to buy properties, cryptocurrencies, and many other assets. If any of those move into

or through the United States financial systems, IRS-CI investigators can trace the money trail. IRS-CI targets the third-party money launderers because it allows investigators to identify a stream of illegal funds from multiple corrupt officials. Once assets are identified, IRS-CI will move to seize and forfeit the assets. IRS-CI's role in protecting the integrity of sanctions issued by the US Government is a critical component to the overall U.S. response to the Russian invasion of Ukraine and other global conflicts.

Case examples include:

Zong Money Laundering/IEEPA Case—12/7/2018

<https://www.justice.gov/usao-ak/pr/former-anchorage-resident-sentenced-federal-prison-international-money-laundering>

- In December 2018, in Anchorage, AK, Mitchell Zong was sentenced to 30 months in prison for conspiracy to commit money laundering with his father, Kenneth Zong. Mitchell Zong laundered approximately \$980,000 of Iranian derived funds knowing the funds came from his father's illegal transactions with Iranian nationals.
- Kenneth Zong had been under indictment in the District of Alaska for 47 violations of International Emergency Economic Powers Act (IEEPA), Providing Unlawful Services to the Government of Iran, Conspiracy to Commit Money Laundering, and Money Laundering.

UniCredit Bank IEEPA Case—4/15/2019

<https://www.justice.gov/opa/pr/unicredit-bank-ag-agrees-plead-guilty-illegally-processing-transactions-violation-iranian>

- In 2019, UniCredit Bank AG (UCB AG), a financial institution headquartered in Munich, operating under the name HypoVereinsbank and part of the UniCredit Group agreed to plead guilty to conspiring to violate IEEPA and to defraud the United States by processing hundreds of millions of dollars of transactions through the U.S. financial system on behalf of an entity designated as a weapons of mass destruction proliferator and other Iranian entities subject to U.S. economic sanctions.
- UniCredit Bank Austria (BA), another financial institution in the UniCredit Group, headquartered in Vienna, Austria, agreed to forfeit \$20 million and entered into a non-prosecution agreement to resolve an investigation into its violations of IEEPA. UniCredit SpA, the parent of both UCB AG and BA, agreed to ensure that UCB AG and BA's obligations are fulfilled.

Cyber/Cryptocurrency Investigations

Since 2014, IRS-CI's Cyber Crimes has proportionately grown in both resources and results. Beginning with one Cyber Crimes Unit in the Washington, DC area consisting of eight agents and a few contractors, CI was able to successfully prosecute some of the first known criminal actors in this space (*e.g.*, Liberty Reserve, Silk Road, and BTC-e). IRS-CI has led the charge in dismantling these dangerous financial criminal organizations. These investigations set the foundation and framework for future efforts. Soon after, CI established a second Cyber Crimes Unit in the Los Angeles Field Office followed by cyber coordinators across the Nation and additional support personnel to provide investigative research and analysis. As staffing increased and capabilities expanded, CI saw an exponential growth in the results garnered. Steady and consistent funding will ensure that IRS-CI maintains their role as the leader in cryptocurrency financial investigations. The rampant growth of these financial crimes in the cryptocurrency area (Ponzi schemes, rug pulls, romance scams, etc.) demand the full attention of the Federal law enforcement community to root out fraud and ensure the integrity of the U.S. financial system.

From FY 2014–FY 2015 when CI was first developing investigative efforts around this area, CI went from a handful of cases to approximately 150 in current inventory. Seizures associated with this program area have increased dramatically from approximately \$700,000 in FY 2019 to current year values exceeding billions. CI Cyber Crimes Investigative Time has remained constant at approximately 6 percent based on the dedicated resources able to address this area of fraud. With additional resources and staffing to this program area, CI would expect to see similar and proportionate rates of growth in many of these statistical areas. The number of victims of cryptocurrency frauds continues to rise in the U.S. The funding associated with the Cyber Crimes initiative significantly enhances CI's ability to access, investigate and analyze information/evidence in an online environment. Investigative tools focused on cryptocurrency tracing, cryptocurrency tax basis calculations, dark web research, open-source intelligence and social media information are continuously as-

sessed to increase the capabilities of CI personnel worldwide. These tools and resources will work in conjunction with the Advanced Collaboration and Data Center (ACDC) to provide a holistic framework for investigative action. ACDC is a Cyber-led, technology-focused resource that enables investigations through data, tools, and expertise. Its mission is to facilitate collaboration internally and externally, as well as equip all field, support, and cyber personnel with the tools and skills to drive the IRS-CI Mission.

Case examples include:

Welcome to Video—10/16/19

<https://www.justice.gov/opa/pr/south-korean-national-and-hundreds-others-charged-worldwide-takedown-largest-darknet-child>

- Largest darknet marketplace for child exploitation.
- Resulted in over 330 arrests and 23 kids saved who were being actively abused.

Bitcoin Hamas—8/13/2020

<https://www.justice.gov/opa/pr/global-disruption-three-terror-finance-cyber-enabled-campaigns>

- Investigation revolved around cryptocurrency fundraising for several terrorist organizations.
- Hamas/Al Qaeda/ISIS used cryptocurrency fundraising intended to carry out criminal acts.
- IRS CI shut this down—largest crypto seizure tied to terrorism to date.

Silk Road \$1-billion Seizure—11/5/2020

<https://www.justice.gov/usao-ndca/pr/united-states-files-civil-action-forfeit-cryptocurrency-valued-over-one-billion-us>

- This case involved cryptocurrency CI traced which was stolen from the administrator of Silk Road that we indicted several years ago.

BITFINEX—2/8/2022

<https://www.justice.gov/opa/pr/two-arrested-alleged-conspiracy-launders-45-billion-stolen-cryptocurrency>

- Two individuals were arrested in Manhattan for an alleged conspiracy to launder stolen cryptocurrency from a virtual currency exchange, presently valued at approximately \$4.5 billion. Thus far, law enforcement has seized cryptocurrency valued over \$3.6 billion linked to that hack.

BITCONNECT—2/25/2022

<https://www.justice.gov/usao-sdca/pr/founder-fraudulent-cryptocurrency-charged-2-billion-bitconnect-ponzi-scheme>

- Satishkumar Kurjibhai Kumbhani, a citizen and resident of India, was indicted for his role in a massive criminal conspiracy involving the cryptocurrency company he founded, BitConnect.
- Kumbhani and his co-conspirators defrauded global investors of over \$2 billion—believed to be the largest cryptocurrency fraud ever charged.

CONCLUSION

Chairman Wyden, Ranking Member Crapo, and members of the committee, thank you again for the opportunity to provide my perspective on this critically important issue. I believe the additional funding provided for the IRS in the IRA is a long-overdue game-changer for the agency, but if it is just a temporary infusion of cash and not a multiyear commitment, the service is likely to fail in its goals. As the adage goes, “You get what you pay for.” The need to balance enforcement with service is the magic mix that will be the difference between the agency being seen as an elite, highly sophisticated agency that helps taxpayers meet their obligations, or an agency that is heavy handed and focuses too much on enforcing laws and not enough time on helping others. For too long, the American public has picked up the tab for underfunding IRS enforcement. By investing in the IRS, we are investing in a set of institutions and infrastructure that are essential to the success and prosperity of our Nation. I urge you to recognize the critical importance of consistent funding for the IRS, and to take action to ensure that the agency has the resources it needs to perform its vital functions.

QUESTION SUBMITTED FOR THE RECORD TO JOHN D. FORT

QUESTION SUBMITTED BY HON. CATHERINE CORTEZ MASTO

Question. You note that only 6 percent of Criminal Investigation reports come from civil referrals. This is a missed opportunity and the result of a lack of investment in all areas of enforcement for many years.

The IRS budget has declined by 20 percent in real dollars from 2010 to 2018 and saw 30 percent of its enforcement workers cut. In your testimony, you noted that the voluntary compliance rate is estimated to be roughly 84 percent, and every 1 percentage point in this level of compliance costs the U.S. approximately \$40 billion.

We know all too well on this committee that IRS does not have the capacity to take calls from organizations to provide clarity nor enough qualified staff to enforce the laws and rules that exist. This is why every year we continue to discuss the dire need for additional dedicated funding for the IRS to do its job.

How could additional dollars help increase enforcement and compliance?

Answer. Ensuring effective tax enforcement and compliance is crucial for maintaining a fair and functioning tax system. As I testified, by increasing funding for the IRS, the government can strengthen its capacity to detect non-compliance, deter tax evasion, and promote voluntary compliance among taxpayers—these are priorities everyone should support. As you note, one of the ways to increase enforcement and compliance is to increase the number of civil audits conducted on high-income individuals. Tax administration only works when everyone is treated the same. Civil audits play a significant role in identifying errors and discrepancies in tax returns, leading to increased compliance among taxpayers. By allocating more resources to the IRS in target areas, more audits can be conducted in a timely manner. This is an important step and directly addresses one of the inputs to the tax gap.

As you touched on in your question, another way to increase enforcement and compliance is to increase the collaboration between the civil and criminal functions of the IRS. While it is true that the number of cases that IRS Criminal Investigation receives from civil fraud referrals are lower than they should be, that number does seem to be trending in the right direction with recent hiring in civil divisions responsible for such referrals. It stands to reason those further increases in these divisions—or the protection of future funding for these divisions—would have a continued increase in collaboration and fraud referral acceptance rates. Increased funding can also support training programs and initiatives that promote information sharing and coordination between these business operating divisions.

Next, an increase in the size of IRS Criminal Investigation (CI) would clearly have a positive impact on enforcement and compliance. Both special agents and professional staff play a key role in bringing the most impactful cases to the Justice Department for potential prosecution. And with CI being the only Government organization that can recommend Federal tax charges, it makes an increase in CI's personnel a necessary recommendation. While CI will never arrest their way out of tax crimes, impactful cases produce results and deterrence—the combination of which increases compliance and enforcement.

Finally, to increase compliance and enforcement, funding should be invested in data analytics and public-private partnerships. Advanced data analytics can help identify patterns of non-compliance, detect tax fraud schemes, and target high-risk taxpayers more effectively. Moreover, collaborating with external partners, such as financial institutions and technology companies, can enhance information sharing and intelligence gathering, leading to improved enforcement outcomes. Funding increases in personnel without investment in these two critical areas is an investment that will not result in the greatest impact to CI and the American taxpayers.

Based on my written and oral testimony, I believe it is clear I believe increased funding is not only good for the IRS, but it is good business policy for the United States. By increasing civil audits, funding further collaboration between civil and criminal functions, expanding the size the criminal division, and investing in data analytics and public-private partnerships, you will increase the IRS's capacity to combat tax evasion and promote voluntary compliance. Thank you for the opportunity to answer your questions and speak about this topic.

SUBMITTED BY HON. RON JOHNSON, A U.S. SENATOR FROM WISCONSIN

EMPOWER OVERSIGHT AND NIXON PEABODY LLP

May 15, 2023

The Honorable Ron Wyden
Chairman
U.S. Senate
Committee on Finance
Co-Chair
Whistleblower Protection Caucus

The Honorable Mike Crapo
Ranking Member
U.S. Senate
Committee on Finance

The Honorable Richard Durbin
Chairman
U.S. Senate
Committee on the Judiciary

The Honorable Lindsey Graham
Ranking Member
U.S. Senate
Committee on the Judiciary

The Honorable Charles Grassley
Member
U.S. Senate
Committee on Finance
Co-Chair
Whistleblower Protection Caucus

The Honorable Jason Smith
Chairman
U.S. House of Representatives
Committee on Ways and Means

The Honorable Richard Neal
Ranking Member
U.S. House of Representatives
Committee on Ways and Means

The Honorable Jim Jordan
Chairman
U.S. House of Representatives
Committee on the Judiciary

The Honorable Jerrold Nadler
Ranking Member
U.S. House of Representatives
Committee on the Judiciary

Dear Chairs and Ranking Members:

Today the Internal Revenue Service (IRS) Criminal Supervisory Special Agent we represent was informed that he and his entire investigative team are being removed from the ongoing and sensitive investigation of the high-profile, controversial subject about which our client sought to make whistleblower disclosures to Congress. He was informed the change was at the request of the Department of Justice.

On April 27, 2023, IRS Commissioner Daniel Werfel appeared before the House Committee on Ways and Means. He testified: "I can say without any hesitation there will be no retaliation for anyone making an allegation or a call to a whistleblower hotline." However, this move is clearly retaliatory and may also constitute obstruction of a congressional inquiry.

Our client has a right to make disclosures to Congress pursuant to 26 U.S.C. § 6103(f)(5) and 5 U.S.C. § 7211. He is protected by 5 U.S.C. § 2302 from retaliatory personnel actions—including receiving a "significant change in duties, responsibilities, or working conditions"¹ (which this clearly is) because of his disclosures to Congress.² Any attempt by any government official to prevent a federal employee from furnishing information to Congress is also a direct violation of longstanding appropriations restriction.³ Furthermore, 18 U.S.C. § 1505 makes it a crime to obstruct an investigation of Congress.

We respectfully request that you give this matter your prompt attention. Removing the experienced investigators who have worked this case for years and are now the

¹ 5 U.S.C. § 2302(a)(2)(A)(xii).

² 5 U.S.C. § 2302(b)(8)(C).

³ The Consolidated Appropriations Act, 2023, Pub. L. 117-328, Div. E, Sec. 713 states:

No part of any appropriation contained in this or any other Act shall be available for the payment of the salary of any officer or employee of the Federal Government, who—

(1) prohibits or prevents, or attempts or threatens to prohibit or prevent, any other officer or employee of the Federal Government from having any direct oral or written communication or contact with any Member, committee, or subcommittee of the Congress in connection with any matter pertaining to the employment of such other officer or employee or pertaining to the department or agency of such other officer or employee in any way, irrespective of whether such communication or contact is at the initiative of such other officer or employee or in response to the request or inquiry of such Member, committee, or subcommittee[.]

subject-matter experts is exactly the sort of issue our client intended to blow the whistle on to begin with.

Cordially,

Tristan Leavitt
President
Empower Oversight

Mark D. Lytle
Partner
Nixon Peabody LLP

cc: The Honorable Michael Horowitz
Inspector General, U.S. Department of Justice

The Honorable Merrick Garland
Attorney General, U.S. Department of Justice

The Honorable Russell George
Inspector General for Tax Administration, U.S. Department of the Treasury

The Honorable Daniel Werfel
Commissioner, Internal Revenue Service

The Honorable Henry Kerner
Special Counsel, Office of Special Counsel

PREPARED STATEMENT OF NATASHA SARIN, PH.D., ASSOCIATE PROFESSOR, YALE LAW SCHOOL, YALE SCHOOL OF MANAGEMENT; AND FORMER TREASURY COUNSELOR FOR TAX POLICY AND IMPLEMENTATION

Chairman Wyden, Ranking Member Crapo, members of the committee, thank you for inviting me to share my views on the importance of adequately funding the Internal Revenue Service—and the generational opportunity to improve our tax system presented by the Inflation Reduction Act’s \$80-billion multiyear investment in the agency.

The IRS is critical to the functioning of our society. It collects 96 percent of the revenue that funds the Federal Government.¹ It touches just about every American household and business each year. It is the largest administrator of Federal benefits in our government, and it was responsible for disbursing critical support to millions of families during the pandemic—for example, through three rounds of Economic Impact Payments and advancing the Child Tax Credit.²

It has done all of this, for far too long, without the resources in place to serve taxpayers or administer the tax laws in the way the American people deserve. Prior to the Inflation Reduction Act’s (IRA’s) passage, the agency could not invest in hiring customer service representatives to answer the phones, or experts in partnership law to unpack passthrough returns, or computer scientists to overhaul the oldest IT system in the Federal Government.

It is no surprise then, that, in the year before the IRA was passed, the agency’s level of service (fraction of telephone calls answered) hovered around 15 percent,³ or that it opened examinations of just 7,500 partnership returns of the more than 4 million it receives each year (an audit rate of approximately zero),⁴ or that millionaire audits dropped off by more than 80 percent in the last decade,⁵ or that the functionality of the taxpayer online account was decades behind what you see in the private sector.

The IRA makes a much-needed, once-in-a-generation investment in the IRS to modernize America’s system of tax administration and, by doing so, meaningfully increase compliance with the Nation’s tax laws. This is a substantial opportunity for the agency and for the Nation’s fiscal situation, and this investment is already

¹ Internal Revenue Service. 2023. “IRS Releases Fiscal Year 2022 Data Book Describing Agency’s Activities, Internal Revenue Service.” April 14, 2023.

² Internal Revenue Service. 2022. “IRS Releases Its 2021 Progress Update Detailing Challenging Year, Internal Revenue Service.” January 7, 2022.

³ National Taxpayer Advocate. 2023. “National Taxpayer Advocate Delivers 2022 Annual Report to Congress; Focuses on Taxpayer Impact of Processing and Refund Delays, Internal Revenue Service.” Internal Revenue Service. January 11, 2023.

⁴ Yellen, Janet, and U.S. Department of the Treasury. 2022. “Secretary of the Treasury Janet L. Yellen Sends Letter to IRS Commissioner in Support of Funding for IRS to Improve Taxpayer Service and Combat Evasion by High Income Earners and Corporations.” U.S. Department of the Treasury. August 10, 2022.

⁵ See Table 2, below.

starting to reap dividends. Thanks to the IRA, the IRS achieved an 87-percent level of service this year—up about 315 percent in just 12 months. Among other accomplishments, the agency answered 2 million more calls this year, cut average phone wait times from 27 minutes to 4 minutes, served 100,000 more taxpayers in person, digitized 80 times more returns by adopting scanning technology, cleared filing backlogs, and more quickly processed tax returns and taxpayer refunds.⁶

In addition to these meaningful service improvements, over the course of the last several months the IRS has also begun to overhaul its tax compliance efforts. This is an area where the agency's nascent efforts have been subject to substantial confusion and misinterpretation.

So, in my testimony today, I would like to make four points about noncompliance in our tax system and the importance of the IRA's investment. First, the tax gap, which is the difference between owed and collected taxes, is large—more than 2 percent of GDP on an annualized basis. This means that even marginal improvement with respect to compliance will have a meaningful impact on our Nation's fiscal position and help address large and growing deficits. Second, the tax gap is concentrated at the top of the income distribution, and it is here that the agency has struggled most in recent years, due to resource constraints. Thus, addressing tax evasion by sophisticated, high-income taxpayers, large corporations, and partnerships is appropriately where the IRS is focused on expending its new resources. Third, investments to address noncompliance are likely to raise much more than official government estimates suggest: My recent work with former Assistant Secretary for Tax Policy Mark Mazur suggests they could reap around \$560 billion in additional tax collection (\$480 billion net of IRA's investment) over the next decade.⁷ And fourth, the benefits of investing in the IRS go beyond revenue collection, as new resources will address longstanding inequities in our tax system and decrease taxpayer burden.

1. THE TAX GAP IS LARGE—GREATER THAN 2 PERCENT OF GDP ANNUALLY

The IRS regularly releases estimates of the Federal tax gap. The most recent estimates cover tax years 2014–2016, where the agency reported a gross tax gap (the difference between taxes legally owed and those voluntarily paid) of around \$500 billion annually, which grew to \$540 billion in 2019, adjusted for growth and inflation. Enforcement efforts help the agency chip away at this total, but it remains substantial—of 2019 taxes owed, the IRS failed to collect \$470 billion even after accounting for its audit and collection efforts.⁸

To put that number into context, it represents 2.2 percent of total GDP in 2019.⁹ It was a whopping 47 percent of the total budget deficit in that year.¹⁰ So, if the United States was able to collect the taxes that were already on the books, deficits would shrink by nearly half. That's without any tax increases or cuts to vital programs like food stamps, veterans' benefits, and Medicaid.

And the IRS's tax gap estimate is likely an understatement of true evasion in the economy. To estimate compliance with the individual income tax, the IRS uses a random sample of a few thousand individual income tax returns each year that are representative of the income tax returns filed for that year. But for other components of the tax gap (*e.g.*, corporate income tax, employment taxes, noncompliance by pass-through entities), the IRS does not conduct similar studies, so it relies on data sources that are less robust. The IRS is explicit that its ability to measure noncompliance in these areas is limited: it cannot “fully represent noncompliance in some components of the tax system, particularly as they relate to corporate income

⁶U.S. Department of the Treasury. 2023. “Filing Season 2023 Report Card: IRS Delivered Significantly Improved Customer Service.” U.S. Department of the Treasury. April 17, 2023.

⁷Sarin, Natasha, and Mark Mazur. 2023. “The Inflation Reduction Act's Impact on Tax Compliance—and Fiscal Sustainability.”

⁸Internal Revenue Service. 2022. “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014–2016”; Internal Revenue Service. 2022. “IRS Updates Tax Gap Estimates; New Data Points the Way toward Enhancing Taxpayer Service, Compliance Efforts, Internal Revenue Service.”

⁹Bureau of Economic Analysis. 2023. “Gross Domestic Product, U.S. Bureau of Economic Analysis (BEA).”

¹⁰U.S. Department of the Treasury. 2023. “Fiscal Data Explains the National Deficit.” 2023.

tax, income from flow-through entities, foreign or illegal activities, and digital assets.”¹¹

The problem of mismeasurement exists even for the individual income tax gap, where for taxpayers at the top of the income distribution, it is possible to shield income, even from audit.¹² So, the net tax gap as measured—which, if left unaddressed, will grow to \$7.7 trillion over the course of the next decade—is a lower bound on the true scale of noncompliance today.

To be sure, eliminating the tax gap entirely is an impossible objective. No matter how many resources the IRS marshals, some tax evasion will persist.

But the fact that such a significant source of revenue exists that is legally owed, but uncollected, means that investments in addressing the tax gap, like the IRA’s investment in the IRS, are a vital tool in addressing our Nation’s fiscal imbalances. Conversely, the failure to invest sufficiently in the IRS—or, defunding the IRS, as some critics have called for—will meaningfully add to our deficits and threaten our long-term fiscal sustainability.

2. THE TAX GAP IS CONCENTRATED

While at the Treasury Department, I estimated the distribution of the tax gap, concluding that the top 1 percent of the income distribution is responsible for nearly 30 percent of unpaid taxes, or about \$2 trillion over the next decade.¹³

The actual number is likely higher for the reasons of mismeasurement discussed above. Because the IRS struggles to estimate the noncompliance of high-income individuals engaging in tax evasion and the corporations and pass-through entities they own, current measures of the distribution of the tax gap overstate the share of tax evasion that is attributable to the bottom and the middle of the income distribution. Getting a clearer picture of the size of the tax gap and its distribution is critical to the IRS’s compliance efforts going forward to help the agency set an appropriate baseline and delineate progress as it invests in its ability to police high-end evasion.

It is worth noting briefly that a challenge with respect to distributional analysis is how best to classify individuals across the income distribution. Official scorekeepers do not impute unreported income in the individual tax model, so current analyses do not provide an overall distribution of unreported income. In the context of recent legislative debates, the Joint Committee on Taxation (JCT) provided an assessment of unreported Schedule C income earned by proprietors, concluding that over half accrues to those making less than \$50,000 annually. But these estimates are based on classifying taxpayers by reported income, rather than true income. And of course, taxpayers who choose to evade their tax liabilities most often do so by underreporting their true level of income. A distribution of Schedule C income based on post-audit income paints a very different picture, as the table below makes clear.

Table 1: Proprietorship, Partnership, and S-Corporation Income

Filer Category	Proprietorship Income (Schedule C)		Partnership and S-Corporation Income (Schedule E)	
	Reported	Adjusted	Reported	Adjusted
Less than \$0	5%	0%	6%	0%
\$0 to \$50,000	52%	13%	34%	3%
\$50,000 to \$100,000	21%	20%	25%	14%
\$100,000 to \$200,000	12%	26%	13%	27%

¹¹Internal Revenue Service. 2022. “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014–2016.”

¹²Recent academic work suggests that evasion by sophisticated taxpayers is underestimated in official IRS estimates because it fails to account for these effects. Guyton, John, Patrick Langetieg, Daniel Reck, Max Risch, and Gabriel Zucman. 2021. “Tax Evasion at the Top of the Income Distribution: Theory and Evidence.”

¹³Sarin, Natasha. 2021. “The Case for a Robust Attack on the Tax Gap.” U.S. Department of the Treasury.

Table 1: Proprietorship, Partnership, and S-Corporation Income—Continued

Filer Category	Proprietorship Income (Schedule C)		Partnership and S-Corporation Income (Schedule E)	
	Reported	Adjusted	Reported	Adjusted
\$200,000 to \$500,000	6%	17%	14%	22%
\$500,000 and over	4%	24%	9%	35%

Source: IRS National Research Program and Congress of the United States, Joint Committee on Taxation.¹⁴

Why does this sort of distributional analysis matter? As the administration made the case for the importance of investing in the IRS in the lead-up to the IRA's passage, it focused on addressing high-end evasion by sophisticated taxpayers. It is here that the IRS has lost the most capacity: audit coverage fell across the board but decreased most at the very top of the income distribution. And coverage has been essentially nonexistent (an audit rate of less than 0.05 percent in 2019, declining from just 0.4 percent in 2010) for complex tax structures like partnerships, which have grown to represent more than 35 percent of total business income.¹⁵

Table 2: Decline in Audit Rates Across Filer Categories

Filer Category	Percent Audited		Percent Decline (2010–2019)
	2010	2019	
All filers	0.9%	0.4%	– 58.1%
Individuals	1.1%	0.4%	– 63.9%
EITC recipients	2.4%	1.1%	– 53.1%
\$1 million–\$5 million	6.7%	1.0%	– 84.7%
\$5 million–\$10 million	11.6%	1.4%	– 87.9%
\$10 million +	18.4%	3.9%	– 78.8%
Corporations	1.4%	0.7%	– 49.6%
with assets over \$20 billion	97.9%	49.9%	– 49.1%
Employment	0.2%	0.1%	– 52.4%
Estates	10.1%	6.9%	– 31.9%

Source: The data in this table was collected from Tables 9a, 9b, and 17b in the IRS Data Books from 2010 and 2019. The IRS stopped releasing audit data for filers by different income brackets. Data for 2019 was supplemented with Table 3 audit rates data from the Government Accountability Office which was released in 2022.¹⁶

Critics of the IRS have focused on inaccurate estimates of the distribution of non-compliance to argue that there is not enough evasion at the top of the distribution to merit these additional investments. An appropriate analysis of the distribution of noncompliance today reveals that this concern is misplaced.

¹⁴*Id.*; Barthold, Thomas. 2021. “Distributional Information.” Official memorandum. Washington, DC: Congress of the United States, Joint Committee on Taxation.

¹⁵Internal Revenue Service. 2023. “Internal Revenue Service Strategic Plan”; U.S. Department of the Treasury. 2021. “The American Families Plan Tax Compliance Agenda.”

¹⁶Internal Revenue Service. 2010. “IRS Data Book.”; Internal Revenue Service. 2019. “IRS Data Book.”; U.S. Government Accountability Office. 2022. “Tax Compliance: Trends of IRS Audit Rates and Results for Individual Taxpayers by Income.” Note that the 2019 Data Book provides a crosswalk of the tables, and the IRS did not publish the number of audits collected on individual filers with incomes of \$1 million, \$5 million, or \$10 million and above in that year. The figures for those numbers were obtained from the GAO, which used 2019 IRS tax data to calculate the audit rate by filer income status.

Both because their tax bills are so large, and because the IRS's capacity at the top of the distribution has declined so drastically over the course of the last decade, this is also where returns to additional enforcement activity are greatest. So it is here where, consistent with the Secretary of the Treasury's very clear directive, and the Commissioner of the IRS's commitment, new enforcement resources will appropriately be focused.

3. INVESTING IN THE IRS COULD RAISE OVER \$500 BILLION IN NEW TAX REVENUE THIS DECADE

When the Congressional Budget Office (CBO) assessed the revenue impact of new investments in the IRS, it concluded that they would raise nearly \$200 billion in new tax collections (or around \$115 billion, net of the cost of new investments).¹⁷ Conversely, as CBO has weighed in on legislation that would rescind the majority of the new funds the agency has received, it has concluded that budget deficits would rise by a similar magnitude over the course of the next decade if these investments in the agency were rolled back.¹⁸

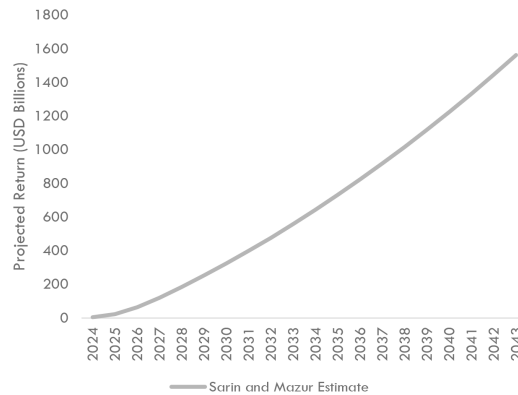
While directionally correct, I believe this conclusion understates the likely return to the substantial long-term investments in the IRS made in the IRA. Mark Mazur and I estimate that the IRA could raise around \$560 billion in new tax collection in this decade (\$480 billion net of investment), or more than three times official scorekeepers' estimates. Depending on the extent of taxpayers' behavioral response, the total could easily be closer to \$1 trillion.

The value of investing in the IRS grows over time, in part because investments in improving information technology and overhauling compliance efforts directed at high-income earners take years to pay off in full. By the second decade, our baseline estimate suggests that new IRA resources will lead to upwards of \$1.5 trillion in total new tax collection, assuming the IRA investments in the IRS are extended.

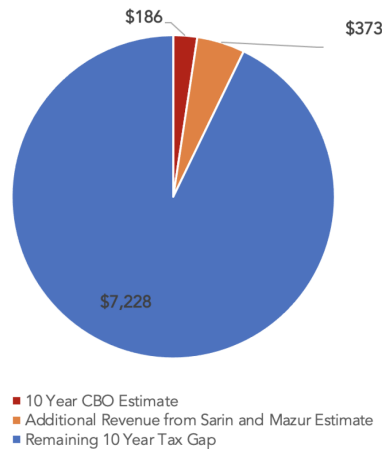
To be sure, this revenue estimate is large. But it is important to put this estimate in context given the scope of tax evasion in the United States today. Over the decade, our baseline estimate is that the IRS will capture just 7 percent of the tax gap which, left unaddressed, would otherwise total more than \$7.7 trillion over this period. That is sizable progress that will reap benefits for the Nation's fiscal position—but it is modest given the size of the tax gap.

¹⁷CBO has released multiple estimates of the additional tax revenue that can be collected by investing in the IRS. In 2021, CBO estimated the returns to a roughly \$80 billion investment in the agency and concluded it would generate almost \$200 billion in new tax revenue (for a net figure for revenue raised of about \$115 billion). (Swagel, Phil, and Congressional Budget Office. 2021. "The Effects of Increased Funding for the IRS.")

¹⁸In 2022, after the Inflation Reduction Act's passage, CBO updated its estimate largely for changes in the legislative language, saying that the IRA's investment in the IRS would increase tax revenues by approximately \$180 billion over the decade. (See Congressional Budget Office. 2022. "Additional Information About Increased Enforcement by the Internal Revenue Service.") Most recently, in 2023, in scoring a potential rescission of the majority of these funds, CBO came to a slightly different revenue estimate of \$186 billion, likely related to changes in the 10-year budget window. (Congressional Budget Office. 2023. "Estimated Budgetary Effects of H.R. 23, the Family and Small Business Taxpayer Protection Act, Congressional Budget Office.")

Chart 1: Projected Cumulative Revenue from Enforcement Investment, 2024-2043

Source: Sarin, Natasha, and Mark Mazur. 2023. “The Inflation Reduction Act’s Impact on Tax Compliance—and Fiscal Sustainability.”

Chart 2: Estimated Enforcement Revenue and the Tax Gap, in Billions

Source: Sarin, Natasha, and Mark Mazur. 2023. “The Inflation Reduction Act’s Impact on Tax Compliance—and Fiscal Sustainability.”

What drives the differences between our estimate and official government estimates? There are several aspects of IRS investments that are underestimated or even ignored by government estimators.

First, official scorekeepers rely on the historical returns to enforcement activities to come to estimates of the gains from new investments, which have averaged around 4:1.¹⁹ But these historical ROI figures do not account for the fact that the IRS is starting from a nadir with respect to its enforcement efforts.

¹⁹Internal Revenue Service. 2022. “Congressional Budget Justification and Annual Performance Report and Plan.”

Official models also do not capture the higher returns associated with pursuing high-end and complex noncompliance, and this is where the IRS is deploying new enforcement resources.²⁰ Further, these estimates include a substantial downward adjustment for diminishing marginal returns, based on the view that the additional revenue potential of investments in the agency declines as more investments are made. While this is certainly true in theory, in practice an agency that has an audit rate of essentially zero in areas of high complexity where evasion is rampant has a ways to go before hitting diminishing returns to new dollars invested.

Additionally, the way government models assess the revenue impact of IRS investments focuses only on the returns to new enforcement dollars, with the implicit assumption that the IRA's investment in taxpayer service and modernized information technology will have no impact on taxpayer compliance. It seems intuitive that, for example, because the IRS was able to answer 87 percent of the calls that it received this year, thanks to new IRA resources, it has been able to help more taxpayers than last year, when it answered just 13 percent of the phone inquiries it received. And yet the compliance benefits from such investments are counted as zero in official tallies.²¹

Further, improved technology will allow the IRS to make better use of information it receives and make more efficient choices when deploying new resources. For example, the IRS today is not making full use of the data it receives from the Foreign Account Tax Compliance Act (FATCA) on offshore bank account holdings, because it does not have the IT capacity needed to absorb and deploy this data.²² This is why the agency's focus on "maximizing data utility," detailed in the recently released IRS Strategic Operating Plan, is of such import.²³

The largest driver of the difference between our and official scorekeepers' estimates has to do with our view of the importance of behavioral changes when taxpayers become aware that there are more tax police on the IRS beat. In the past, CBO has included only direct effects in its revenue estimates.²⁴ It recently began thinking about the role of behavioral effects, but concluded these were small in magnitude.²⁵ We believe, on the basis of past empirical work on this question, that the magnitude is significantly larger.²⁶

Taxpayer behavior is impacted by IRS enforcement efforts in two ways. First, there is a self-deterrent effect: taxpayers who make errors that the IRS identifies are unlikely to repeat them in future years. Second, there is a community deterrent effect: taxpayers who observe a well-resourced IRS are more likely to follow the laws on the books. In the same way that a State trooper on the highway median encourages driving within the speed limit, improved IRS enforcement efforts encourage compliance with the tax laws. Treasury has previously stated that deterrent effects are likely three times the size of direct effects.²⁷ Yet our estimates adopt a very conservative deterrence factor of just one, essentially equaling the size of the direct ef-

²⁰ As one datapoint, as Treasury Inspector General for Tax Administration Russell George has pointed out in the past, an extra hour spent auditing a taxpayer who makes \$5 million or more annually generates thousands of dollars (his 2021 estimate was over \$4,500). See U.S. Congress, Senate, Committee on Finance, Closing the Tax Gap: Lost Revenue From Noncompliance and the Role of Offshore Tax Evasion, Hearing before the Subcommittee on Taxation and IRS Oversight, 117th Cong., 1st sess., May 11, 2021.

²¹ Prior academic work that taxpayers respond to agency-provided information services by increasing compliance, see e.g., McKee, Michael, Caleb A. Siladke, and Christian A. Vossler. 2018. "Behavioral Dynamics of Tax Compliance When Taxpayer Assistance Services Are Available." *International Tax and Public Finance* which includes a summary of related literature. In a different setting, researchers found that IRS-provided information on penalties paid for lacking health insurance coverage increased insurance coverage and decreased mortality. Goldin, Jacob, Ithai Z. Lurie, and Janet McCubbin. 2021. "Health Insurance and Mortality: Experimental Evidence from Taxpayer Outreach." *The Quarterly Journal of Economics* 136 (1): 1–49. This is an area where more research, especially following the IRA's investment, will be valuable.

²² U.S. Government Accountability Office. 2019. "Foreign Asset Reporting: Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad."

²³ Internal Revenue Service. 2023. "Internal Revenue Service Strategic Plan."

²⁴ Congressional Budget Office. 2020. "Trends in the Internal Revenue Service's Funding and Enforcement."

²⁵ Swagel, Phil, and Congressional Budget Office. 2021. "The Effects of Increased Funding for the IRS."

²⁶ See e.g., Boning, W.C., J. Guyton, R. Hodge, and J. Slemrod. 2020. "Heard it through the grapevine: The direct and network effects of a tax enforcement field experiment on firms." *Journal of Public Economics* 190(3–4): 104261

²⁷ Internal Revenue Service. 2019. "Program Summary by Budget Activity."

fects measured by increased revenue collection from enforcement actions such as audits.

So, our \$480-billion estimate of the net gains from IRA enforcement activities strikes us as more likely to be an underestimate than an overestimate of how much the IRS investment will add to the fisc in the decade ahead. Treasury's 3-to-1 deterrence factor would raise the revenue collected over the course of the next decade to more like \$1 trillion, in line with prior academic estimates of the large returns to the IRS modernization efforts.²⁸

The importance of this fiscal moment provides greater urgency to the IRA's historic investment in the IRS, and it also reflects the importance of accurately assessing the revenue potential of the long-term investment that Congress has authorized. For example, in the context of debt ceiling negotiations, some have proposed rescinding the IRA's investment in the agency, citing the inaccurate view that increased enforcement efforts will inevitably cause an uptick in burden for ordinary taxpayers.

I believe it is important to appreciate how much progress has been made by investing in the IRS—and also how much there is to lose from defunding the agency as some have recommended. The same will be true in the context of appropriations conversations in the years ahead: if this mandatory funding has to be deployed to plug shortfalls in ongoing year-to-year operations rather than on modernization efforts, this will bear meaningfully on the revenues that the IRS is ultimately able to collect.

To be sure, the success of the IRS in collecting the revenue we estimate from a robust attack on the tax gap is not a given. The agency will have to deploy these resources and modernize in such a way that it is able to collect from sophisticated taxpayers who have at their disposal significant resources and the assistance of a bevy of tax advisors to continue to skirt the rules. It will need to recruit new types of talent—partnership law experts, data scientists, economists, technologists—to quickly ramp up complex enforcement efforts. In the years ahead, it will be imperative for Congress, in its oversight capacity, to continue to monitor the progress of the agency and help to course correct as modernization efforts get underway.

But it is also important not to understate the historic investment that you have made in the IRS—an investment in the fiscal sustainability of our Nation's finances that it is imperative to preserve and supplement, rather than diminish, in the years ahead.

4. INVESTING IN THE IRS WILL CREATE A MORE EQUITABLE TAX SYSTEM

Investing in a 21st-century tax administrator helps important tax policy goals beyond revenue. Perhaps even more important are efforts to address the deep inequities of a tax system that does not have resources in place to police evasion by a select few.

Regular American taxpayers—the vast majority of your constituents—earn wages and find their taxes automatically withheld, so generally they pay their tax obligations on that income in full: Compliance rates are 99 percent on wages and salary income. And yet opaque sources of income have compliance rates of around 50 percent—and these types of income are disproportionately earned by the most sophisticated and high-income taxpayers.²⁹ This creates a two-tiered tax system where most Americans today pay all that they owe, but some do not.

Most Americans feel that some corporations and wealthy people do not pay their fair share.³⁰ They are right to feel that way: They do not. And they will not, until the IRS has the resources that it needs to pursue noncompliance so sophisticated taxpayers that choose to evade their liabilities bear costs that are sufficient to deter future malfeasance. Addressing evasion will alleviate a tax on compliant taxpayers that arises from the fact that future government funding needs that result in tax increases are borne only by the population that is law-abiding. It will also remove a competitive disadvantage from our Nation's economy, where those who are civi-

²⁸ See e.g., Sarin, Natasha, and Lawrence Summers. 2020. "CBO Recognizes, but Understates, Potential of Tax Compliance Efforts." *Tax Notes*, July 20, 2020; Rossotti, Charles, and Fred Forman. 2020. "Recover \$1.6 Trillion, Modernize Tax Compliance and Assistance," *Tax Notes*, March 2, 2020.

²⁹ Internal Revenue Service. 2022. "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014–2016."

³⁰ Oliphant, J. Baxter. 2023. "Top Tax Frustrations for Americans: The Feeling That Some Corporations, Wealthy People Don't Pay Fair Share." Pew Research Center. April 7, 2023.

cally responsible and pay their taxes in full can be undercut by competitors who choose to evade and pocket tax savings.

There is a related benefit to the IRS's enforcement efforts that is perhaps counter-intuitive at first. For honest taxpayers, the impact of an IRS with more compliance resources will be a lower burden associated with enforcement activities—not a higher one. Historically, with outdated technology and blunt enforcement tools, the IRS has struggled to separate taxpayers who have complied with their tax obligations from those who have not. But with improved data, the agency will be able to gain a more fulsome picture of taxpayer behavior, and thus identify discrepancies, in a way that it simply cannot today. This means the likelihood of an audit for a compliant taxpayer will go down, not up, in the years ahead.

It will be on the IRS to show how taxpayer burden is decreased, but the likelihood of being wrapped up in a costly enforcement process should decline as the agency is better able to target scrutiny where it belongs—on high-income evaders, as opposed to those who are fully compliant with their tax obligations today.

Given that the IRS touches nearly every household and business each year, I believe strongly that recent investments in the agency will meaningfully improve trust in the tax administrator in ways that are consequential for the IRS and the Federal Government writ large. A demonstrably more equitable system of tax administration has the virtue proving the value and importance of good government to the American populace.

PREPARED STATEMENT OF PETE SEPP, PRESIDENT, NATIONAL TAXPAYERS UNION

Chairman Wyden, Senator Thune, and members of the committee, I am honored by your invitation to present the following comments concerning the issues of Internal Revenue Service (IRS) funding, particularly as it relates to enforcement of Federal tax laws and overall Federal finances.

INTRODUCTION

My name is Pete Sepp, and I am President of National Taxpayers Union (NTU), a nonpartisan citizen group founded in 1969 to work for less burdensome taxes, more efficient, accountable government, and stronger rights for all taxpayers. More about our work as a non-profit grassroots organization is available at www.ntu.org.

Although we advocate for many structural changes to the tax system, from the comprehensive to the incremental, one common aspect on which NTU often specifically focuses is the *administrability* of such proposals. As policymakers define the rates, bases, deductions, credits, and other features of a tax system, what will the practical impact be on taxpayers' lives and their rights? Unless this question is adequately addressed, the result will be a tax system that burdens all and serves none. Taxpayers will be more fearful or mistrustful of their government, revenue officials will encounter greater difficulty in performing their public service, tax practitioners will become increasingly frustrated with complex rules, and all sectors of the economy will pour too many productive resources into compliance tasks that only marginally affect actual compliance.

For these reasons, throughout its history NTU has led efforts in support of congressional legislation to improve operations of the Internal Revenue Service (IRS) and provide greater balance in the tax law enforcement process. During the late 1970s and 1980s, NTU informed Congress of taxpayers who experienced IRS maladministration firsthand, as well as organized a large coalition of civil liberties organizations that successfully persuaded Congress to enact the first "Taxpayers' Bill of Rights" as part of the Technical and Miscellaneous Revenue Act of 1988.

In 1996 and 1997, NTU's then-executive vice president David Keating was named to the National Commission on Restructuring the Internal Revenue Service ("Restructuring Commission"), a Federal panel whose recommendations later became the basis for the most extensive IRS overhaul in a generation.¹

More recently we worked with the IRS National Taxpayer Advocate (NTA) and Congress in promulgating and finally codifying (in 2015) a set of 10 fundamental taxpayer rights. We also led a large coalition of organizations to formulate and pass

¹For background, see National Commission on Restructuring the IRS. "A Vision for a New IRS." June 25, 1997. Available from: <https://cybercemetery.unt.edu/archive/natcommirs/20160104232208/http://www.house.gov/natcommirs/object.htm>.

through Congress the bipartisan Taxpayer First Act of 2019—and gratefully participated in the extensive stakeholder consultation process after enactment that led to the production of the comprehensive Taxpayer First Act Report of early 2021.

Since that time, NTU has also urged a cautious, deliberative approach—but not wholesale opposition—to proposals for increased IRS funding. As I wrote in *The New York Times* in October 2021, supporting additional IRS funding:

More resources for customer service, taxpayer rights safeguards, a functioning Oversight Board, actionable and regularly updated research on the tax gap and innovative approaches such as the recently proposed enforcement fellowship pilot program are all solutions that should unite Washington.²

Thus, we do not appear before the committee to advocate blocking all additional funding for the IRS, and would indeed argue that locking in certain multiyear appropriations for IRS investments (e.g., Information Technology) is sensible.³ In fact, it is this history of my organization that informs much of the remarks to follow about the present and future circumstances of IRS funding and Federal finances.

Here I wish to acknowledge the outstanding contributions to this testimony from several of my colleagues at National Taxpayers Union and National Taxpayers Union Foundation: Joe Bishop-Henchman, executive vice president of National Taxpayers Union Foundation; Demian Brady, vice president of research, National Taxpayers Union Foundation; Andrew Lautz, former director of Federal policy; and Andrew Wilford, director of the Interstate Commerce Initiative, National Taxpayers Union Foundation. Their research and writing has greatly informed and improved the document you are reading today.

POLITICAL REALITIES: BOTH PARTIES MUST LEAD ON SOUND TAX ADMINISTRATION,
AND BOTH HAVE SHOWN THEY CAN DO IT TOGETHER

Before turning to the details of the topic at hand, NTU urges all members of the committee to recognize several important, yet inescapable political realities confronting Washington today.

First, the votes in the House of Representatives to claw back the IRS funding designated for “enforcement” in the Inflation Reduction Act (IRA) are as far in the legislative process as these proposals will go—it cannot be realistically argued that they could pass the Senate intact, much less survive a presidential veto. Nor, given the political state of Congress, will the appropriations or reconciliation processes permit the House Republican majority to make massive IRS budget reductions for the next 2 fiscal years. Even if that political state changes in 2025, as a practical matter no significant alterations to the current IRS funding amount would be likely until Fiscal Year 2026.

Knowing this, opponents of the IRA must turn their immediate attention to how this amount should best be spent.

Second, both the House and Senate Democratic caucuses have historically insisted upon strict congressional planning, guidance, and oversight of Federal law enforcement programs and the agencies carrying out those programs. For example, when several PATRIOT Act provisions regarding surveillance were up for renewal in 2011, Rep. John Conyers (D–MI) said:

Section 215 of the PATRIOT Act allows a secret FISA court to authorize our government to collect business records or anything else, requiring that a person or business produce virtually any type [of] record. We didn’t think that that was right then. We don’t think it’s right now. This provision is contrary to traditional notions of search and seizure which require the government to show rea-

²Sepp, Pete. “I’m the President of the National Taxpayers Union. Be Careful with I.R.S. Reform.” *New York Times*. October 18, 2021. <https://www.nytimes.com/2021/10/18/opinion/tax-irs-reform.html>.

³In 2021, former IRS Commissioner John Koskinen observed the following about the \$80 billion of additional IRS funding contained in the Biden administration’s American Families Plan: “I’m not sure you’d be able to efficiently use that much money.” Rappeport, Alan, and Tankersley, Jim. “Biden Seeks \$80 Billion to Beef Up IRS Audits of High Earners.” *New York Times*. April 27, 2021. <https://www.nytimes.com/2021/04/27/business/economy/biden-american-families-plan.html>.

sonable suspicion or probable cause before undertaking an investigation that infringes upon a person's privacy.⁴

In 2016, after Congress learned of civil asset forfeiture laws being wielded unfairly against taxpayers, the late Rep. John Lewis (D-GA) joined with then-Rep. Peter Roskam (R-IL) in support of taxpayer protections in the DUE PROCESS Act. Chairman Lewis said at the time, "I have never, ever seen in a very long time, this degree, this spirit of togetherness. On this issue, we are on one accord."⁵ Chairman Lewis, who I had the honor to meet in 2017, inspired our organization when he said of the Taxpayers First Act, "even in the most difficult times, we can come together as a Nation, as a people and as a Congress to accomplish important things for the American people."⁶ Democrats should be proud of their tradition in supporting taxpayer rights, counting among other leaders on this issue David Pryor (D-AR), J.J. Pickle (D-TX), and Harry Reid (D-NV).

With this history, supporters of the IRA must turn their immediate attention to applying the same general philosophy behind these examples from other parts of Federal law enforcement, to how the IRS should operate when it acts in a law enforcement capacity.

The third reality is more pleasant and hopeful. For decades, NTU has seen bipartisan collaboration and cooperation on a variety of tax administration initiatives to improve the way the IRS works while enhancing compliance with the law and protecting taxpayer rights. Our testimony will provide abundant opportunities for building upon this bipartisan comity in a later section.

HISTORICAL REALITY: IRS TRANSFORMATION WON'T SUCCEED WITHOUT CONGRESSIONAL PLANNING, OVERSIGHT

But why should bipartisan comity on tax administration matter at this particular point in time? The history of IRS funding provides an instructive, and urgent, reason why.

Although much has been made of IRS budget reductions as if they followed a straight line according to which party was in power, on an inflation-adjusted basis, the history of IRS funding from 1992–2022 is best described as peaks and valleys. After hitting a low in 1997, IRS resources increased significantly through the year 1999, recovering after a dip to reach more than \$14 billion (in 2022 dollars) in 2006. Then began an uneven path to a new height of nearly \$15 billion in 2011, and once more taking considerable declines until 2019. Today, after accounting for inflation, IRS funding is only moderately higher than it was 5 years ago.⁷

It should be noted that two of the three major IRS funding ramp-ups occurred after enactment of key IRS reform laws (the IRS Restructuring and Reform Act, or RRA 98 and the Taxpayer First Act, or TFA 2019). Both bills passed with near-unanimous margins in Congress. The third was connected to several events, including implementation of the American Recovery and Reinvestment Act of 2009 and the Affordable Care Act of 2010.

The point we wish to emphasize here is that major investments in the IRS's capacity have been preceded by extensive legislating from Congress, in close consultation with IRS leadership. RRA 98, for example, was fundamentally shaped by the 18-member National Commission on Restructuring the IRS, and appointed by Congress and the executive branch. According to its nearly 200-page report, over the course of a year of operation:

The Commission received extensive input from American taxpayers and experts in the IRS and tax system, holding 12 days of public hearings and spending

⁴ See, *ontheissues.org*. Debate over RESTORE Act. March 14, 2008. https://www.ontheissues.org/MI/John_Dingell_Homeland_Security.htm.

⁵ See, Sibilla, Nick. "After Sending Armed Agents to Seize Bank Accounts, IRS Announces New Policy to Return Assets." *Forbes*. June 24, 2016. <https://www.forbes.com/sites/instituteforjustice/2016/06/24/irs-structuring-policy/?sh=393caba51a87>.

⁶ See, Sepp, Pete. "An Appreciation: Congressman John Lewis, 1940–2020." National Taxpayers Union. July 27, 2020. <https://www.ntu.org/publications/detail/an-appreciation-congressman-john-lewis-1940-2020>.

⁷ See Brady, Demian. "What the IRS's New Enforcement Budget Means for Taxpayers." National Taxpayers Union Foundation. September 21, 2022. Retrieved from: <https://www.ntu.org/foundation/detail/what-the-irss-new-enforcement-budget-means-for-taxpayers>. Also, Bishop-Henchman, Joseph. "Transforming the Internal Revenue Service." Cato Institute Policy Analysis No. 942. April 11, 2023. <https://www.cato.org/policy-analysis/transforming-internal-revenue-service>.

hundreds of hours in private sessions with public and private sector experts, academics, and citizen's groups to review IRS operations and services. In addition to holding three field hearings . . . the Commission met privately with over 500 individuals, including senior-level and front-line IRS employees across the country. . . . The Commission also received continuous input from stakeholder groups and congressional representatives, and conducted research and surveys to better understand IRS operations and gauge the American public's view of the IRS. Finally, the Commission reviewed thousands of reports and documents on IRS operations, management, governance, and oversight.⁸

The resulting legislation based in part on this report also involved numerous hearings and markups by multiple Committees and Subcommittees, resulting in a 184-page final bill which, in turn, helped to guide innumerable revisions to strategic plans, Internal Revenue Bulletins, and Internal Revenue Manual procedures.

By contrast, title I, part 3 of the Inflation Reduction Act contained all of nine paragraphs outlining \$79.6 billion in tax administration-related funding. Just three of those nine paragraphs explain how \$78.9 billion (99 percent) of the total should be spent.

Some would argue that the IRS funding in the Inflation Reduction Act was never intended to be as transformational as RRA 98. Perhaps this was initially the case, given the brevity of instructions Congress provided about the resource infusion. As we note below, the IRA, utilizing the reconciliation process, seemed much more focused on "hitting a number" to achieve a desirable 10-year budget score than transforming the IRS.

Whatever the intentions during legislative negotiations, it is now abundantly clear that advocates of the IRA are describing the new money in sweeping terms. In transmitting the IRA Strategic Operating Plan to Secretary Yellen, Commissioner Werfel himself wrote that "the contents of this plan provide a vision for the future of Federal tax administration." The Plan itself grandly notes that the IRA funding is "a historic opportunity to transform the administration of the tax system and the services provided to taxpayers."

Plenty of discussions continue to take place in the policy world over the proper level of IRS funding as well as the best mix between taxpayer service, compliance initiatives, business systems, and other items.

Regardless of how those discussions land, NTU offers this reminder: never before has the IRS—or, to our recollection, any existing Federal agency—received such a large boost of funding in percentage terms with so little planning, safeguards, or prospects of outside managerial oversight. It is now well past time for every member of Congress to recognize this fact and act accordingly.

MANAGERIAL REALITY: COMPLIANCE IS THE GOAL, NOT "ENFORCEMENT"

The word "enforcement" has become a common yet unfortunate shorthand in Washington for the goal of obtaining better *compliance* with the tax laws. The choice of words matters, because it predefines the direction of a conversation that ought to pursue many paths to a desirable destination. "Enforcement" should never be an end in itself, or a performance metric to justify budgets. Otherwise, policymakers will simply focus on increasing audit rates, math error notices, criminal convictions, and other tactics without being held accountable for a measurement that is actually meaningful: compliance with tax laws that is less difficult, less expensive, and more sustainable than it is today.

This definition should have currency even for those who believe that the "investment" of taxpayer dollars into "enforcement" was the primary reason for title I, part 3 of the IRA. The less money the IRS spends—and the more methods employed beyond traditional "enforcement"—to obtain compliance, the better the fiscal result will be.

But the language of the IRA itself points to the problem of distinguishing ends and means elucidated above. Title I, part 3 is helpfully entitled, "Funding the Internal Revenue Service and Improving Taxpayer Compliance." After that point, the minimal descriptions of where the funding shall be directed fail to capture how compliance is a multifaceted issue. For example, the relatively small amount for "tax-

⁸National Commission on Restructuring the IRS. "A Vision for a New IRS." June 25, 1997. Available from: <https://cybercemetery.unt.edu/archive/natcommirs/20160104232208/http://www.house.gov/natcommirs/object.htm>.

payer services” describes “pre-filing assistance and education” along with “taxpayer advocacy services” as allowable expenses under the section. The following section, with a very large amount for “enforcement,” describes “activities . . . to determine and collect owed taxes” as well as “legal and litigation support.”

This categorization fails to appreciate the interrelatedness of “taxpayer services” and “enforcement” to compliance. From Earned Income Credit claimants all the way up to Form 1120 filers reporting Controlled Foreign Corporation activities, “pre-filing assistance and education” can forestall numerous situations that could result in noncompliance. Both the “legal and litigation support” and “activities to determine and collect owed taxes” could easily lead taxpayers to lean more heavily on “taxpayer advocacy services.” In other words, improved taxpayer services can go a long way to improve compliance with our tax laws, yet certain enforcement activities can further increase demands for taxpayer services.

National Taxpayer Advocate Erin Collins put it best when she observed:

The most efficient way to improve compliance is by encouraging and helping taxpayers to do the right thing on the front end. That is much cheaper and more effective than trying to audit our way out of the tax gap one taxpayer at a time on the back end.⁹

The division of funding also illustrates how the funding gap between “taxpayer services” (\$3.18 billion) and “enforcement” (\$45.6 billion) is even worse than it appears. High-profile IRS actions since passage of IRA funding in the area of services have primarily focused on “front-end” matters such as hiring more telephone operators and addressing return processing backlogs. What will be left for pre-filing education and taxpayer advocacy services after these flashier improvements have been fully funded? As the next section explains, the financial reckoning is approaching quickly.

FISCAL REALITY: IRS BURN RATES ON CUSTOMER SERVICE AND MODERNIZATION SHOULD BE CONCERNING—ESPECIALLY FOR “ENFORCEMENT”

While policymakers, reporters, and other stakeholders have devoted much attention to the supplemental IRS “enforcement” funding included in the IRA, NTU has also been closely tracking the agency’s use of supplemental customer service and modernization funding. There is a bipartisan interest in ensuring that the IRS both improves the taxpayer experience and upgrades severely outdated information technology infrastructure.

In its IRA Strategic Operating Plan released in April, the IRS estimated that it would obligate around \$1.65 billion of its supplemental Taxpayer Services funding by September 30, 2024.¹⁰ This means that more than half (52 percent) of the agency’s allocation for enhanced Taxpayer Services activities will have been obligated in the first 3 fiscal years of the 10-year allocation.¹¹ Similarly, the IRS projects it will have obligated nearly 35 percent (\$1.66 billion out of \$4.75 billion) by September 30, 2024, just 3 years into the 10-year allocation.¹²

By comparison, the IRS will have only obligated 13.6 percent of its supplemental Operations Support funding (\$3.46 billion out of \$25.33 billion) and 3.9 percent of its supplemental Enforcement funding (\$1.78 billion out of \$45.64 billion) by the end of FY 2024.¹³

The IRS has many ambitious goals and initiatives in its Strategic Operating Plan focused on customer service and modernization. Its very first objective is to “[d]ramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible,” and its second objective is to “[q]uickly resolve taxpayer issues when they arise.”¹⁴

⁹Waggoner, Martha. “Taxpayer services should get more of that \$80 billion, advocate says.” *Journal of Accountancy*. March 17, 2023. <https://www.journalofaccountancy.com/news/2023/mar/taxpayer-services-get-more-80-billion-advocate-says.html#:~:text=%22The%20most%20efficient%20way%20to,time%20on%20the%20back%20end.%22>

¹⁰IRS. (April 2023). “Internal Revenue Service Inflation Reduction Act Strategic Operating Plan: FY 2023–2031.” Retrieved from: <https://www.irs.gov/pub/irs-pdf/p3744.pdf> (accessed May 11, 2023).

¹¹The first of 10 fiscal years, FY 2022, was also a noticeably short period for the IRS to obligate funding in the IRA. President Biden signed the Inflation Reduction Act into law on August 16, 2022, and FY 2022 ended just 6 weeks later, on September 30, 2022.

¹²Internal Revenue Service, *supra* note 10.

¹³*Ibid.*

¹⁴*Ibid.*

The agency outlines 12 initiatives under its first objective, including such important efforts as “be[ing] able to file all documents securely and exchange correspondence electronically” and providing “greater upfront clarity and certainty additional guidance on tax issues.”¹⁵ The IRS outlines seven initiatives under the second objective, including “provid[ing] taxpayers with timely and tailored post-filing treatments to resolve issues and omissions on their tax returns” and “send[ing] taxpayers notices they can understand, delivered in ways they prefer, with clear explanations of issues and steps to resolution.”¹⁶

NTU agrees with many of these initiatives and would like to see the IRS succeed. Indeed, success could result in a vastly improved taxpayer experience with the IRS, the central goal of the bipartisan, recently enacted Taxpayer First Act of 2019.

But as explained in the previous section, even those who support an “enforcement”-heavy approach to IRS budgets should be concerned about the agency’s projected burn rate for supplemental Customer Service and Modernization funding. After all, the Strategic Operating Plan for the IRS acknowledges that “all our efforts as outlined in this plan—including in the areas of customer service, issue resolution, and effective enforcement—will increase overall tax compliance.”¹⁷

The objectives and initiatives above are ambitious and transformational. Many of them are also expensive. NTU encourages the committee to engage with Commissioner Werfel and senior IRS officials to determine whether these initiatives will require Customer Service funding beyond levels provided by Congress, and how the IRS plans to square its forward-looking initiatives with the need to hire and retain the additional customer service representatives that made this most recent tax filing season less disruptive than COVID-era filing seasons.

Now might be an opportune time for lawmakers to consider reallocating a portion of IRA funding away from the more flush Enforcement and Operations Support accounts and towards Customer Service and Business Systems Modernization. The National Taxpayer Advocate, Erin Collins, recently called for just that sort of reallocation in a March blog post on the Taxpayer Advocate Service’s website:

My office doesn’t have the financial expertise to determine the costs associated with each initiative. But at a high level, two things are clear: (1) the IRS needs substantially more funding than it was receiving in annual appropriations bills to better serve U.S. taxpayers, and (2) the additional funding provided by the IRA, while appreciated and welcomed, is disproportionately allocated for enforcement activities and should be reallocated to achieve a better balance with taxpayer service needs and IT modernization. We need to put taxpayers first.¹⁸

Tax practitioners have offered a similar recommendation of late. The American Institute of Certified Public Accountants (AICPA) recently recommended that the Treasury Department and IRS address “imbalance[s]” between the enforcement account and taxpayer services account:

. . . [G]iven the historic low levels of IRS taxpayer services, we are concerned that there was an insufficient allocation of funding in the IRA to improve taxpayer services to appropriate levels. We are concerned that service challenges will persist unless sufficient, targeted funding for technology improvements, human talent and training, and taxpayer services are appropriated.¹⁹

These stakeholders are not partisan, and they are certainly not invested in seeing the IRS funding provided in the IRA fail. That should underscore for members of this committee that there is a compelling, non-ideological case to consider diverting a portion of IRA funds away from well-funded accounts and towards critical activities that would improve taxpayer services.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Ibid.*, p. 8.

¹⁸ Collins, Erin. “NTA Blog: National Taxpayer Advocate Urges Congress to Maintain IRS Appropriations but Re-Direct Some Funds Toward Taxpayer Service and Information Technology Modernization.” March 16, 2023. <https://www.taxpayeradvocate.irs.gov/news/nta-blog-nta-urges-congress-to-maintain-irs-appropriations-but-re-direct-some-funds-toward-taxpayer-service-and-it-modernization/> (accessed May 11, 2023).

¹⁹ AICPA. (March 28, 2023). “Re: IRS Operational Plan for Resources Included in the Inflation Reduction Act of 2022.” <https://aboutblaw.com/7i7>.

FISCAL REALITY: PINPOINTING THE IMPACT OF IRA'S "ENFORCEMENT" FUNDING, OR
CHANGES TO THAT FUNDING, MISSES THE POINT OF IRS TRANSFORMATION

Since the stated topic of this hearing is "House Republican Supplemental IRS Funding Cuts: Analyzing the Impact on Federal Law Enforcement and the Federal Deficit," I will turn to the latter topic.

As you know, the nonpartisan Congressional Budget Office (CBO) estimated in August 2022 that the \$80 billion in enhanced IRS resources included in the IRA would increase Federal revenues by \$203.7 billion (on a non-scorable basis, due to CBO scoring conventions) from Fiscal Years 2022 through 2031.²⁰ If one were to count those estimated revenues as contributing to deficit reduction, as many supporters of the IRA have, the net deficit reduction projected from the IRS provisions over the same 10-year period was \$123.7 billion.

A month later, CBO revised down the non-scorable revenue increases from FYs 2022 through 2031, from \$203.7 billion to \$180.4 billion. Making the same assumptions as above, the net deficit reduction from IRS provisions was revised down to \$100.4 billion over 10 years.²¹ Subsequent legislation from House Republicans to repeal significant portions of the IRA's IRS funding—including all supplemental amounts for enforcement and operations support—were scored as increasing deficits by \$114.4 billion from FYs 2023 through 2032²² and \$119.7 billion from FYs 2023 through 2033.²³

NTU Foundation vice president of research Demian Brady previously reviewed the numerous reasons why increased revenue collections by the IRS under the IRA's supplemental funding may fall short of CBO's expectations:

- ". . . [T]he final version of the IRA dropped a provision granting the IRS expedited hiring authority. In the absence of that authority, it will take longer to onboard and train new employees, reducing the level of expected collections.
- "As inflation leads to higher cost-of-living adjustments for Federal workforces, the IRS may not be able to hire as many people with the funding provided (though the number of additional FTEs would still be much larger than mainstream media estimates). This would further undermine revenue estimates."
- "Challenging the IRS can be costly and drag on for an extended period of time, but the agency is by no means always successful in securing judgments against those it accuses of fraud. NTUF previously compiled a list of news articles where the IRS had taken an overaggressive position against taxpayers and ultimately lost in court."²⁴

Each of those concerns remain relevant to the agency and to CBO's estimates today.

NTU and NTU Foundation were even more skeptical of the revenue estimates offered by the Treasury Department in 2021, in the lead-up to consideration of the Build Back Better Act and the IRA. In September 2021, then-Acting Assistant Secretary for Tax Policy Mark Mazur wrote that:

²⁰ Congressional Budget Office (CBO). (August 5, 2022). "Estimated Budgetary Effects of H.R. 5376, the Inflation Reduction Act of 2022." Retrieved from: https://www.cbo.gov/system/files/2022-08/hr5376_IR_Act_8-3-22.pdf (accessed May 11, 2023).

²¹ CBO. (September 7, 2022). "Estimated Budgetary Effects of Public Law 117-169." Retrieved from: https://www.cbo.gov/system/files/2022-09/PL117-169_9-7-22.pdf (accessed May 11, 2023).

²² CBO. (January 9, 2023). "Estimated Budgetary Effects of H.R. 23, the Family and Small Business Taxpayer Protection Act, as Posted on the Website of the Clerk of the House of Representatives on January 9, 2023, as an Item That May Be Considered Pursuant to a Rule." Retrieved from: https://www.cbo.gov/system/files/2023-01/hr23_IRS.pdf (accessed May 11, 2023).

²³ CBO. (April 25, 2023). "Re: CBO's Estimate of the Budgetary Effects of H.R. 2811, the Limit, Save, Grow Act of 2023." Retrieved from: https://www.cbo.gov/system/files/2023-04/59102-Arrington-Letter_LSG%20Act_4-25-2023.pdf (accessed May 11, 2023).

²⁴ Brady, Demian. "What the IRS's New Enforcement Budget Means for Taxpayers." NTU Foundation, September 21, 2022. Retrieved from: <https://www.ntu.org/foundation/detail/what-the-irss-new-enforcement-budget-means-for-taxpayers> (accessed May 11, 2023).

Conservatively, about \$400 billion of additional revenue can be collected (incorporating both the direct and indirect effects of enforcement investment) from the President's proposals, net of the \$80 billion investment.²⁵

The nonpartisan scorekeepers at CBO clearly disagreed with this assessment—and in fact ultimately estimated revenue effects about a fourth the size of the Treasury Department's 2021 estimates—but the IRS insisted as recently as April 2023, upon the publication of its Strategic Operating Plan, that (emphasis ours):

The Congressional Budget Office estimates that the additional \$80 billion provided to the IRS by the IRA will increase Federal revenue by more than \$180 billion in the decade ahead, considering only direct enforcement revenue based on additional staffing.²⁶

We remain skeptical that the IRS will spend IRA resources in an efficient and effective enough manner to reach the revenue estimates established by CBO. In addition to the concerns outlined above, the IRS is already reporting to stakeholders that it is stretched thin on resources to implement the clean energy provisions included in the IRA. The Strategic Operating Plan suggests that some of the supplemental resources available to the IRS under the IRA will need to be diverted to implementation of IRA clean energy provisions.²⁷ Might this cut into the additional revenues CBO previously projected the IRS could collect through increasing enforcement activities? Time will tell, but lawmakers should monitor IRS implementation of the funding closely to see if net deficit reduction is occurring at rates projected by CBO or the Treasury Department.

None of these concerns should be taken to mean we doubt the premise that better tax compliance can enhance Federal revenue. Rather, NTU simply returns to our earlier, cautionary advice in this testimony that it is a mistake to engage in transformational compliance initiatives simply to reach a particular “offset” for government spending in one piece of legislation.²⁸ The revenue collection number from IRA funding for compliance (or even the clumsy misnomer “enforcement”) is, on net, likely to be quite a bit more than zero.

There are other fundamental matters to consider at today's hearing, in addition to whether the actual net deficit result will be \$100.4 billion, or \$50.2 billion, or something else. What types of metrics for example, besides, revenues, will be used to track enforcement activities? In the 1980s and 1990s, Congress acted to make certain that performance and promotion evaluations for individual IRS employees were not based on collection quotas.²⁹

The IRS Strategic Operating Plan outlines a number of activities that will take compliance in partially or entirely new directions, which could easily impact the CBO estimates described earlier in unpredictable ways. These include:

- “Develop a process for continually refining compliance analytics models based on feedback and new information” for audits. Robust models could prevent wasted resources, but flawed or biased ones could just as easily lead the Service down costly rabbit holes.
- “Develop and implement a plan to improve the IRS Whistleblower Program.” NTU is a longtime supporter of the IRS Whistleblower Program, and whistleblower protection laws throughout the Federal Government. In fact, the focused information and “leads” from this program could prove more effective

²⁵ Mazur, Mark J. “The Revenue Impacts of Compliance Proposals.” Department of the Treasury Office of Tax Policy. September 14, 2021. Retrieved from: https://home.treasury.gov/system/files/136/Yellen_Neal_Congressional_Budget.pdf (accessed May 11, 2023).

²⁶ IRS. (April 2023). “Internal Revenue Service Inflation Reduction Act Strategic Operating Plan: FY 2023–2031.” Retrieved from: <https://www.irs.gov/pub/irs-pdf/p3744.pdf> (accessed May 11, 2023).

²⁷ *Ibid*; see the table on page 129, which indicates the agency proposed to invest \$3.9 billion on implementing “Energy security” provisions of the IRA rather than \$0.5 billion Congress specifically earmarked for such provisions.

²⁸ As an example, certain additional revenues expected from the Foreign Account Tax Compliance Act (FATCA) have not materialized as expected, for a number of reasons. “When FATCA was implemented, it was estimated to bring in \$8.7 billion in revenue over the next 10 years. Although total revenues tied to the legislation are unclear, the IRS has collected less than \$14 million over the last 12 years.” See <https://brighttax.com/blog/fatca-update-april-2022>.

²⁹ See, for example, Parker, John. “IRS Officers Pressured to Make Seizures, Ex-Chief Says.” *Daily Oklahoman*. August 19, 1998. <https://www.oklahoman.com/story/news/1998/08/19/irs-officers-pressured-to-make-seizures-ex-chief-says/62271734007/>. And, Associated Press. “IRS Suffers ‘Seizure Fever,’ Agents Tell Subcommittee.” *Los Angeles Times*. June 23, 1987. <https://www.latimes.com/archives/la-xpm-1987-06-23-fi-10105-story.html>.

for compliance and audits than hit-and-miss data dragnets that require costly resources and end up targeting innocent taxpayers. Depending on how and when this program upgrade is prioritized, however, key opportunities for revenue recovery could be missed.

- “Develop approaches and new treatments for large partnership enforcement by leveraging data and analytics.” A Treasury Inspector for Tax Administration (TIGTA) report from last year reported that the “no-change” in partnership audits ranged from 78 to 90 percent.³⁰ How much the IRS’s new “approaches” affect that rate could mean billions of revenue dollars either way. We would hasten to add that many of the energy provisions in the IRA would allow for the “sale” of tax credits from taxpayers who could not fully utilize them to others. These transactions would likely involve the very partnerships that many IRA supporters seem to view with suspicion. The political pressure on the IRS’s partnership audit goal could thus be acute, and diminish possible revenue collections.

The greatest uncertainty in revenue estimates, however, is the basis on which they are projected: the “tax gap” itself. Other witnesses will be providing greater detail than NTU’s testimony on this issue; our work suggests that while the tax gap is considerable, measuring its size depends not only on taxpayer behavior, but also shifts in the economy, and of course, interpretations of how laws actually apply.

The historic fluctuations in official estimates of the tax gap are an illustration of the volatile nature of the issue. Earlier this year Joe Bishop-Henchman, a colleague at our sister organization National Taxpayers Union Foundation, wrote:

The IRS released its latest estimates of the tax gap in 2022. The IRS found that the annual gross tax gap for 2014–2016 was \$496 billion. After late payments and enforcement actions, the net tax gap was \$428 billion. That figure represented 2.7 percent of GDP, the same as estimates for other recent years, and down from 3.3 percent in 2001 and 3.4 percent in 2006. The IRS estimates that the gap in 2017–2019 dipped to 2.6 percent of GDP.

International studies show that the United States has a fairly low tax gap compared to other countries. In a 2018 study, Polish economists Konrad Raczkowski and Bogdan Mróz estimated tax gaps for 35 countries, including 28 EU countries and the United States. They put the U.S. gap at 3.8 percent of GDP and the EU gap at 7.7 percent of GDP. . . . In a 2019 study, political economist Richard Murphy estimated that the tax gap for 28 EU countries was equivalent to 5.6 percent of GDP. The latest IRS study puts the U.S. Federal tax gap at 2.7 percent, but with an estimated state-local tax gap added, the U.S. total tax gap would be about 4.2 percent of GDP.³¹

But what of the as-yet-indeterminate components of the tax gap, such as digital assets, that are not fully incorporated into conventional estimation methodologies? A National Taxpayers Union Foundation analysis from 2021 illuminated some of the obstacles to reaching a firm calculation, at a time when then-Commissioner Rettig ventured the total tax gap “could approach and possibly even exceed” \$1 trillion:

A rough IRS estimate in 2018 placed the tax gap from cryptocurrency at about \$11.5 billion, back when the digital cryptocurrency market was worth an estimated \$500 billion.

Even assuming the IRS has failed to improve at all on its previously estimated noncompliance rate of 50 percent, this extrapolates to a cryptocurrency tax gap of just under \$50 billion based on the 400 percent increase in global market capitalization that digital currencies have enjoyed since then. That is of course a significant amount, but it is also only around 12 percent of the \$381 billion tax gap estimate.

The IRS also has not made a concrete estimate of offshore holdings which are going untaxed. Research the IRS helped fund and authored in part by left-wing economist Gabriel Zucman placed the amount of American offshore holdings in low-tax jurisdictions at just over \$1 trillion. They arrive at this number by as-

³⁰ Bonner, Paul. “BBA Partnership Audits Show High No-Change Rates, TIGTA Says.” *Journal of Accountancy*, March 28, 2022. <https://www.journalofaccountancy.com/news/2022/mar/bba-partnership-audits-show-high-no-change-rate-tigta-says.html>.

³¹ Bishop-Henchman, Joseph. “Transforming the Internal Revenue Service.” Cato Institute Policy Analysis No. 942. April 11, 2023, pp. 9–11. <https://www.cato.org/policy-analysis/transforming-internal-revenue-service>.

suming that 95 percent of wealth in these holdings is concealed from the IRS, an estimate which is likely high.³²

Nevertheless, even if one assumes this data is entirely correct, the authors still estimate just \$15 billion in uncollected tax revenue per year. Combining this number with the estimate of roughly \$50 billion in uncollected cryptocurrency tax revenue, we are still shy of \$500 billion, let alone \$1 trillion.³³

NTU does not contend that complete repeal of IRA's "enforcement" portion of IRS funding will have zero deficit impact, relative to the current budget baseline of which IRA is now a part. Nor, however, should IRA's supporters contend that shifting "enforcement" funding into other IRS functions has a simple linear upward impact on future deficits.

Nor should serious policy advocates on either "side" of the IRA ignore the *net* revenue impacts of IRS funding decisions. One factor in this equation is whether increased compliance burdens on all taxpayers in an income class to ferret out just the noncompliant taxpayers, diverts resources from legitimate, profitable activities that might otherwise be taxed. We leave the detailed analysis of that matter to another witness on this panel, Chris Edwards, but we acknowledge its importance.

In sum, precisely because the IRS would engage in brand-new compliance strategies, precisely because measurements of the tax gap and the hidden economy are fluid, and precisely because other options like improved customer service to enhance compliance have not been adequately explored, the deficit impact of IRA changes cannot easily be measured to the nearest \$10 billion, or likely even to the nearest \$100 billion.

It is also why tying this exercise to tax and spending legislation passed through the reconciliation process, is a far from helpful way to discuss the fiscal consequences of the transformation now occurring at the IRS. Defining the success of this transformation, and then making that success a priority, will yield enhanced revenue in the future. Arguing now over what exactly that revenue will be over a fixed period of time will, ironically, distract policymakers' attention from the very tasks needed to see those revenues come to fruition in the first place.

POLICY REALITY: EVEN IF THE "\$400,000 PLEDGE" IS KEPT, ALL TAXPAYERS WILL BE AFFECTED BY IRA COMPLIANCE FUNDS

A byproduct of the policy debate over IRA has been a fixation on Secretary Yellen's directive (reiterated by Commissioner Werfel) "not to increase audit rates relative to historical levels for small businesses and households earning \$400,000 per year or less." No less than half a dozen Questions for the Record submitted during Commissioner Werfel's confirmation hearing before this committee contained variations on that theme.³⁴

As my colleagues and I have written before, the \$400,000 threshold is, in itself, subject to all manner of interpretation, besides the obvious question of how to define "historical rate":

- Does that amount represent adjusted gross income, modified adjusted gross income, taxable income, total positive income, or some other measure? Is it what a taxpayer reports on their return for the year the IRS wishes to conduct an examination, or is it what the IRS believes the taxpayer's taxable in-

³²This is especially the case since the passage of the Infrastructure Investment and Jobs Act, after the National Taxpayers Union Foundation analysis was published. The law extends the \$10,000-plus cash transaction reporting requirement businesses to digital assets, giving the IRS a new stream of data to examine for possible tax evasion. New estimates of revenues from this area of tax compliance will need to be adjusted to reflect efforts already underway.

³³Wilford, Andrew, Moylan, Andrew, and Sepp, Pete. "The Tax Gap: No Trillion-Dollar Silver Bullet." National Taxpayers Union Foundation. May 13, 2021. <https://www.ntu.org/foundation/detail/the-tax-gap-no-trillion-dollar-silver-bullet>. Note former National Taxpayer Advocate Nina Olson's observation:

Equating the entire tax gap to "tax evasion" is just so disingenuous. And it's also wrong; it's incorrect. Evasion has a technical meaning under the law, and generally it requires mens rea, a criminal intent. So much of it is error, or inadvertent . . . there are a bunch of different types of noncompliance. And if you say [it's all tax evasion]—and that's what *The Washington Post* called it, that's what *The New York Times* called it—then that creates distrust among the taxpayers of the tax agencies. [They're asking], "why am I paying if you're letting all these people off the hook?"

³⁴United States Senate Committee on Finance. "Finance Committee Questions for the Record, Hearing on the Nomination of Daniel Werfel, Responses by Daniel Werfel." February 24, 2023. <https://www.finance.senate.gov/download/responses-to-questions-for-the-record-to-daniel-werfel>.

come ought to be after proposed adjustments? If the latter, greater numbers of Americans than advertised will be subject to scrutiny, perhaps to no avail.

- Does this directive create a “marriage penalty,” in the sense that the IRS could investigate a single taxpayer’s return reporting above \$400,000, but could also look into a joint return where each taxpayer earns \$200,000? Dual-earner households in large cities could be surprised to find themselves under the microscope.
- What year will govern the audit decision—the year of the return under examination, or the taxpayer’s present circumstances? A business owner who earned \$500,000 during the good times of 2019 might be shocked to get an audit notice next year if she finds herself struggling with half that cash flow today. In fact, high-income tax returns are also among the most volatile in reporting year over year incomes.
- What happens if the directive is disobeyed or unintentionally violated? The Secretary’s ability to impound funds is highly limited. And if “accidents” happen, how can a taxpayer possibly be made whole? A Treasury directive does not carry the force of law in court, and regardless, no outside entity will be monitoring IRS audit rates in real time.³⁵

Do these concerns amount to parsing words? Perhaps, but the operation of the entire tax system often depends upon this very exercise, as Congress proves with myriad technical corrections to various tax laws, or with numerous controversies that wind up in the courts. Only very recently have clues begun to emerge on how exactly the IRS will keep this “pledge,” but the definition has yet to be settled.

Of greater importance, the IRS’s own Strategic Operating Plan makes no secret that several compliance and enforcement efforts that have little to do with audits will apply to all taxpayers:

- “Expand capacity and resources for our non-filer and return-delinquency programs.”
- “Create processes for real-time identification of taxpayers who miss payments”
- “Develop and pilot new collection treatments based on data and analytics.”
- “Centralize compliance analytics and develop a process to regularly model the population of tax returns.”³⁶

These projects are couched in terms of providing better service to taxpayers; and as for regular modeling of the tax return population, this is undoubtedly preferable to plowing ahead with compliance initiatives based on a poor understanding of the filing population. Nonetheless, they demonstrate that even if a strict \$400,000 per-filing unit threshold, based on taxable income for the year audited, is faithfully adhered to, other types of “enforcement” and compliance projects from IRA funding will affect middle-class and moderate-income taxpayers.

There are also practical considerations that will soon become evident. Suppose, for instance, IRS counsel are pursuing two cases in Tax Court with virtually identical facts and circumstances, thereby utilizing the same legal strategies in both actions. In the first action, the Service prevails against a taxpayer with an income (however measured) of \$415,000. The second action, yet to be decided, involves a taxpayer with an income of \$385,000. It is foolish to assume that the Service would suddenly drop the second case and walk away because of some fluid income threshold that doesn’t even have a definition in statute.

In addition, even the most precise analytics and data collection in the area of tax compliance are likely to yield “false positives”—potential audit selections that fall at or under the \$400,000 threshold for some reason. Indeed, some situations may require innovative and advanced modeling for a particular behavior (*e.g.*, concealing digital assets) regardless of income, and then identifying on purpose those who exceed the \$400,000 threshold for possible audit. What happens to the “accidental” or

³⁵For more detail, see Brady, Demian. “What the IRS’s New Enforcement Budget Means for Taxpayers.” National Taxpayers Union Foundation. September 21, 2022. Retrieved from: <https://www.ntu.org/foundation/detail/what-the-irss-new-enforcement-budget-means-for-taxpayers>.

³⁶IRS. (April 2023). “Internal Revenue Service Inflation Reduction Act Strategic Operating Plan: FY 2023–2031,” pp. 56, 58, 60, and 66. Retrieved from: <https://www.irs.gov/pub/irs-pdf/p3744.pdf> (accessed May 11, 2023).

“incidental” data collected from this exercise for households who fall under the threshold? Will a handful of taxpayers at the \$390,000 threshold be allowed to skate away from an audit? What if a million taxpayers making less than \$100,000 are suspected of concealment? Will this portion of the data simply be destroyed, or used in some other non-audit compliance manner?

Historically, it is also true that IRS tactics honed for use against one class of taxpayers are soon deployed against others. Information Document Requests (IDRs), once primarily a feature of large-business audits, are now commonplace in examinations involving firms with dozens rather than thousands of employees. In the mid-2010s, the use of designated summons power and designating cases for litigation in the examination and investigation process had become so widespread as to attract the attention of Congress and prompt limited reforms in the Taxpayer First Act.³⁷

Finally, the simple fact is that money is fungible. As Demian Brady of National Taxpayers Union Foundation explained:

Nothing the IRS receives in annual appropriations, over and above the IRA funds, would be subject to the \$400,000 taxpayer income limitation. The Service could also simply request from Congress, or to a more limited degree, redirect, more funds from what it would otherwise normally spend on high-income enforcement activities toward those lower on the scale. Furthermore, neither Secretary Yellen nor Congress demanded that any kind of public accounting be kept on how enforcement dollars will be used against certain types and classes of taxpayers. Additional monies in the IRA to the Treasury Inspector General for Tax Administration could be employed for such purposes, but here again, the legislation is silent on where TIGTA is supposed to look.³⁸

Congress could rectify this issue by following up with a demand for such a detailed accounting of high-income “enforcement” expenditures, but another form of reconciliation is necessary too: that IRA compliance funding will touch the entire taxpaying population, even if one enforcement tool is aimed at higher-income filers. Once this reality is accepted, the need for a holistic, systemic approach to compliance that respects all taxpayers’ rights, regardless of their circumstances, will become apparent.

RECOMMENDATIONS: BALANCING COMPLIANCE, FISCAL RESPONSIBILITY, AND TAXPAYER RIGHTS

If the IRS is to deliver what the Commissioner calls “the modernized tax administration system the American people deserve,” that achievement will not be solely because of the IRS’s efforts. It will take a number of major commitments throughout government and the private sector to effectuate. The following are some of NTU’s top priorities for members of the committee to consider. Some require direct congressional action, while others will benefit simply from your leadership and support.

(1) DEPLOY EXISTING ASSETS FOR MANAGEMENT, INCLUDING THE IRS OVERSIGHT BOARD

We begin our list with this item for a reason. Congress cannot, on its own, effectively oversee the IRS’s strategic plan without institutions that are dedicated to monitoring and making course corrections to the Service’s strategies and tactics on a consistent basis.

No other entity is better suited to this task than the IRS Oversight Board. Created in the IRS Restructuring and Reform Act of 1998 with the purpose of bringing in outside experts to oversee the “administration, management, conduct, direction, and supervision” of IRS operations. It was specifically tasked with reviewing and

³⁷ See, for example, Sepp, Pete. “Statement Prepared for the Subcommittee on Economic Growth, Tax, and Capital Access, Committee on Small Business, United States House of Representatives, Regarding the Subcommittee’s Hearing on ‘Audits and Attitudes: Is the IRS Helping or Hurting Small Businesses?’” Submitted June 22, 2016. <https://www.ntu.org/publications/detail/statement-of-pete-sepp-to-house-subcommittee-regarding-irs-small-business-reforms>. Here we also note the analyses that many small businesses undergo when evaluating whether to challenge what they believe to be an erroneous IRS assessment, leading many to pay the tax owing to the costs of appeal or litigation. Today, given statistics of average disputed amounts of tax on small business returns (see IRS Data Book for FY 2022, <https://www.irs.gov/statistics/soi-tax-stats-irs-data-book>), even some in income categories of \$500,000 up to \$1 million might make a similar judgment.

³⁸ Brady, Demian. “What the IRS’s New Enforcement Budget Means for Taxpayers.” National Taxpayers Union Foundation. September 21, 2022. Retrieved from: <https://www.ntu.org/foundation/detail/what-the-irss-new-enforcement-budget-means-for-taxpayers>.

approving the annual and long-range strategic plans of the IRS, including its mission and objectives. It can do so for 2023's Strategic Operating Plan,

The Board is supposed to have nine members, including the Treasury Secretary and the IRS Commissioner as standing members along with seven positions appointed by the President and nominated by the Senate. One of the appointees must be either a Federal employee or a representative of IRS employees, but otherwise, as noted, the intention of the 1998 Act was to bring people with private sector experience into discussions regarding the agency's operational challenges. Such experience need not be focused on managerial issues like IT or personnel. Private-sector Board members could bring valuable perspectives on how to measure the tax gap, where taxpayer and customer behavior patterns overlap, and how arbitration and mediation can resolve disputes.

Even though appropriations for the IRS (as well as IRA) continue to include language providing support funding for the Board, it has unfortunately gone dormant since 2015 due to a lack of a quorum. That problem can be rectified almost immediately, by encouraging the President to send Board nominees to the Senate for quick confirmation.

Reviving the Board won't be easy, but it is the first big test of whether policymakers are serious about making the Strategic Operating Plan work. Given that there was so little legislative collaboration on IRA versus RRA 98, it is more imperative now than it was 35 years ago. This committee can create a safe space for doing so, by reaching out to and encouraging the White House to send nominees for the Board to consider as soon as possible.

At the same time, it is also apparent that little consultation with the IRS Advisory Council (IRSAC) and the Electronic Tax Administration Advisory Council (ETAAC) took place prior to production of the Strategic Operating Plan.³⁹ This needs to change. IRSAC and ETAAC could focus on rectifying specific issues raised by the IRS Oversight Board, relying on their experience as practitioners and experts on many aspects of tax administration.

Leveraging the underappreciated Taxpayer First Act Report of 2021 likewise falls under this category. The Strategic Operating Plan would appear to contain an impressive level of detail in its 150 pages, but beyond the graphics, the generous font for text, and the "Key Projects" and "Milestones" sections is a fair amount of repetition and vagueness in how the "Operating" part of the plan would actually work. The Taxpayer First Report, spanning 254 pages, gives many detailed insights into how taxpayer service, personnel training, and organizational restructuring could modernize the IRS. These include how divisions of the Service can be reorganized to improve the taxpayer experience, how outreach to underserved taxpayer communities can be improved, and how risks to managerial failure can be mitigated.

While NTU does not agree with every approach in the report, the stakeholder outreach process, detailed in the report's appendices, is a good starting point for the kind of collaboration the IRS, in conjunction with Congress, the Oversight Board, IRSAC, ETAAC, and other stakeholders must follow going forward.

We would not wish to neglect mentioning the need to speedily evaluate another nominee that may soon be coming the committee's way—IRS Chief Counsel. The committee may of course find this nominee qualified or unacceptable, but it would be a mistake to simply defer action of any kind for months on end once the nominee is designated. Former IRS officials and tax practitioners alike have told us that the Service's legal team is especially sensitive to leadership from the top. Again, while the Biden administration may send a poor choice for Chief Counsel to the committee, it is important for members to act quickly to reject such a nominee, rather than leave the post unfilled and the Chief Counsel's office with a weak rudder that could steer IRS's legal strategy in even less helpful directions for taxpayers.

- (2) CREATE "OFF-RAMPS"—A WORKING APPEALS PROCESS, SETTLEMENT INITIATIVES, AND ADR—TO PROTECT TAXPAYERS AND SAVE GOVERNMENT RESOURCES

The Taxpayer First Act of 2019 should have been the final word in a nearly century-long line of orders from Congress to provide an independent, neutral forum

³⁹ One member of IRSAC recently told me that the Council received little more than a private briefing just prior to the release of the plan. The Finance Committee could, and in our opinion should, ask IRS management for an explanation of the lack of consultation with IRSAC and ETAAC.

for taxpayers and the government to resolve disputes without going to court. In addition to codifying the IRS Independent Office of Appeals, the 2019 law also limited the circumstances under which the Service could use tactics to deny appeal rights. Its language specifically stated that while the Treasury could provide “reasonable exceptions,” the ability to appeal was to be “generally available to all taxpayers” who were not taking “frivolous position[s],” as defined by 26 U.S.C. § 6702(c).⁴⁰

In November 2022, the IRS proposed a rulemaking with no fewer than 24 exceptions to appeal rights, including several that were clearly aimed at legitimate appeals challenging procedural validity of regulatory or subregulatory guidance. One reason the Service gave for its limits on appeals was resource constraints. But as NTU noted in comments filed in response to the rulemaking:

We also believe that additional funding for the Office would be an acceptable and welcome use of a portion of the \$80 billion in funding Congress has appropriated to the agency for use over the next 10 years under the Inflation Reduction Act (IRA) of 2022. In fact, additional spending to expand appeals rights and independent review of tax controversies could ultimately *save* the agency money over the long run, by obviating more expensive and protracted litigation over tax controversies. The agency could also see indirect savings from improved taxpayer compliance, should taxpayers have confidence in a more robust Independent Office of Appeals.⁴¹

The IRS Strategic Operating Plan would seem to support this funding direction, by calling to “[increase] staff in the Independent Office of Appeals to resolve tax controversies arising from enhanced compliance efforts.” Commissioner Werfel himself affirmed that the appeals process should be a way to properly air facts and circumstances of individual cases, stating that a “one-size-fits-all approach would not be aligned with these rights [to appeal].”⁴²

Without additional congressional guidance, however, the IRS’s rulemakings could stand, and appeals could still be a limited channel for taxpayers to assert their rights. One excellent way to provide that guidance would be through committee markup and reporting to the floor of Senator Cornyn’s “Small Business Taxpayer Bill of Rights” (S. 1177).⁴³ This legislation would clarify and strengthen appeal rights by effectively banning *ex parte* communications between the Appeals office and the rest of the IRS, as well as preventing the Appeals office from raising new issues or theories with taxpayers when meeting with them.

Another problem resolution method the Service should embrace more fully, where facts and circumstances of many taxpayers are indeed in closer alignment, is the settlement initiative. Pioneered over 40 years ago under then-IRS Commissioner Roscoe Egger, this concept allows the IRS to offer limited-time legal settlements to taxpayers in cases with no litigation hazard and where there are no precedents to be set or compliance problems in the absence of a trial. Depending on the issue at hand, a taxpayer might be able to keep a fraction of their deduction or credit in question, or could be limited only to their “cash outlays” in claiming a tax benefit. In the years that followed, settlement initiatives were successful in clearing numerous cases from crowded court dockets on matters such as the amortization of intangibles, a targeted jobs tax credit, and perhaps most successfully, in 2008, the lease-in/lease-out and sale-in/lease-out (LILO/SILO) controversy. Both the government and taxpayers benefited from reduced time and litigation costs, while the Treasury recovered tens of billions in revenues that might otherwise have entailed considerable effort and risk to recover.⁴⁴

Still another promising avenue is alternative dispute resolution (ADR), through mediation and binding arbitration. Common in tax systems around the world from

⁴⁰Sepp, Pete, and Lautz, Andrew. “Comments re: 87 FR 55934, ‘Resolution of Federal Tax Controversies by the Independent Office of Appeals.’” November 14, 2022. <https://www.ntu.org/publications/detail/ntu-offers-comments-to-irs-on-resolution-of-federal-tax-disputes>.

⁴¹United States Senate Committee on Finance. “Finance Committee Questions for the Record, Hearing on the Nomination of Daniel Werfel, Responses by Daniel Werfel.” February 24, 2023, pp. 22–23. <https://www.finance.senate.gov/download/responses-to-questions-for-the-record-to-daniel-werfel>.

⁴²Sepp, Pete and Lautz, Andrew. “Senate Bill Would Provide Small Business Taxpayers with New Rights.” National Taxpayers Union. May 17, 2021. <https://www.ntu.org/publications/detail/senate-bill-would-provide-small-business-taxpayers-with-new-rights>.

⁴³For excellent background, see Gomez, Armando, and Barral, Roland. “It’s High Time to Clear Out the Tax Court’s Easement Backlog.” *Tax Notes Federal*, Volume 179, April 10, 2023. <https://www.taxnotes.com/exempt-organizations/conservation-easements/its-high-time-clear-out-tax-courts-easement-backlog/2023/04/25/7g8xx>.

the United Kingdom to Portugal to Australia, ADR allows taxpayers of limited means or time the ability to quickly obtain results that are fair to all parties. The National Commission on Restructuring the IRS gave extensive consideration to improving Alternative Dispute Resolution methods for use in Federal tax controversies, including mediation as well as binding arbitration. Limited procedures were in place at that time, applying primarily to cases of over \$10 million or more. ADR at the tax agency was a relatively new concept, following passage of the government-wide Administrative Dispute Resolution Act of 1996.

Ultimately, the Commission did not make major recommendations in this area, although the subsequent 1998 RRA did remove the dollar threshold, and establish a pilot program for binding arbitration. Unfortunately, the usefulness of ADR for most taxpayers has so far been questionable. The National Taxpayer Advocate's 2016 Annual Report to Congress has made the IRS's failure to "effectively use ADR" as #15 on the "Most Serious Problems" list.⁴⁴

With ADR confined largely to the periphery of taxpayer service offerings by the IRS, the IRA funding infusion could easily stand up a more robust program. A legislative framework for doing so already exists in S. 1177.

Some may object to these "off ramps" as essentially "escape routes" for wealthy taxpayers. Aside from the fact that the U.S. Constitution does not define rights by income levels, all of these procedures actually inure most to the benefit of those whose legal resources are limited. Furthermore, they can aid in compliance by reinforcing public trust that these options for settling disputes are available *to all* and provide a "fair shake" *for all*. At the same time, expanding their availability would optimize revenue collection at the most efficient level of expenditure for the government, delivering early returns on IRA's funding.

There are also reputational risks to consider when evaluating alternatives. In recent years the government has pursued increasingly exotic positions in court, on both substantive matters such as appraised values in tax deductions and Foreign Bank Account Registration penalties, to procedural matters such as the limits of the Administrative Procedure Act and "1 day late" taxpayer responses. The result has been embarrassing losses all the way up to the U.S. Supreme Court, some involving 9–0 rulings.⁴⁵ It can be argued that the government's use of "strategic ambiguity" in court can actually spawn noncompliance from taxpayers who have diminished respect for the government's position and feel they have little to lose by not settling disputes.

(3) EXAMINE AND EVALUATE, IN DETAIL, THE COMMISSIONER'S AND TAXPAYER ADVOCATE'S RECOMMENDATIONS ABOUT THE FUNDING MIX UNDER IRA

With two of the Nation's top tax administration officials clamoring for a remedy to the "funding cliffs" for taxpayer services in IRA's funding for the Internal Revenue Service, this committee can exercise leadership now by examining in-depth whether and how title I, part 3 of the IRA (as well as other IRS funding) should be adjusted to reflect more immediate needs. This should also include business systems modernization, which could require more resources than anticipated. Again, NTU emphasizes that this examination should not be viewed as "zero-sum." Enhanced taxpayer services and business systems modernization can make significant contributions to compliance and resulting revenues. Of course, the committee is not the arbiter of appropriations, but it is uniquely equipped, along with the House Committee on Ways and Means, to comprehensively review the IRS's fiscal trajectory. This needs to take place in "real time," as appropriations season gets into full swing.

(4) FOCUS ON A WIDE RANGE OF COMPLIANCE TOOLS

As this testimony has made quite clear, the goal of "compliance" does not always require the means of "enforcement." As far back as 1997, Ernest Dronenburg, a member of the National Commission on Restructuring the IRS, and former California Board of Equalization leader, remarked that:

⁴⁴For background, see, Sepp, Pete. "Comments before the Subcommittee on Oversight, Committee on Ways and Means, 'IRS Reform: Resolving Tax Disputes,'" September 13, 2017. <https://www.ntu.org/publications/detail/irs-reform-resolving-taxpayer-disputes>.

⁴⁵For background, see Bishop-Henchman, Joseph. "Transforming the Internal Revenue Service." Cato Institute Policy Analysis No. 942. April 11, 2023, pp. 5–6, 13–14. <https://www.cato.org/policy-analysis/transforming-internal-revenue-service>.

A .5-percent increase in voluntary compliance resulting from taxpayer education and changing attitudes would increase revenue in my state by over \$400 million annually. Conversely, doubling our current audit coverage from 3 percent to 6 percent would produce less than half that amount.⁴⁶

Over the past 35 years, research into the effectiveness of non-“enforcement” compliance tools has become more sophisticated, with encouraging results. For example, at the IRS/Tax Policy Center 2022 Joint Research Conference on Tax Administration, researchers Brian Galle and Alexander Yuskavage presented a paper that examined the impact of “non-monetary sanctions” on tax compliance. Utilizing a data set of California’s “Top 500” delinquent taxpayers (obviously high-income earners), they found “strong positive compliance responses” to a program that employed notices such as those “warning of the imminent publication of a taxpayer’s personal information and potential license suspension.”⁴⁷ At the 2021 joint conference, Paul Organ presented research indicating that “collateral sanctions” via the IRS’s passport certification and revocation process have “an immediate and strong positive effect on compliance actions for many of those denied a passport request.”⁴⁸ These tactics, while potentially more focused and less intrusive than a levy or lien to satisfy a tax debt, would still need to be wielded with caution.⁴⁹

But there are many other compliance methods that are less coercive. On a recent “Tax Chat!” hosted by the Center for Taxpayers Rights’ President Nina Olson, several experts in the field of tax compliance stressed the importance of building public trust in the government’s expertise and fairness, not just fear of punishment. Erich Kirchler, a psychologist from the University of Vienna, Austria, noted that using a well-developed definition, each 1 percent increase in public trust of a tax authority led to more than double that percentage in compliance. Furthermore, the panelists discussed how “nudges,” such as asking for additional information on a tax return can help to resolve compliance issues before rather than after filing. One example a panelist gave was a large drop in claimed dependents when filers were required to list the Social Security numbers of those dependents. Notably, all agreed that the IRA’s funding ratio of “enforcement” to “taxpayer services” was far too lopsided.⁵⁰

If the IRS Strategic Operating Plan’s goal of being able to “help the taxpayer to become as compliant as possible” is to be achieved, then tools such as these will need to be deployed in greater abundance. An Oversight Board, combined with congressional encouragement, could make a serious difference in making that happen.

(5) DEVELOP BETTER MEASURES FOR ALTERNATIVE COMPLIANCE STRATEGIES

“Data and Analytics” is an oft-repeated theme in the IRS’s Strategic Operating Plan for estimating the tax gap, finding patterns of non-compliance, and improving the taxpayer service experience. Yet, little has been discussed about the uses of data and analytics for alternate compliance tools as well as the impact of enforcement on the private sector.

At the 2023 Donald C. Lubick Symposium sponsored by the Tax Policy Center, former National Taxpayer Advocate Nina Olson observed that very little work has been done to accurately measure the fiscal benefit to tax compliance by providing improvements in IRS taxpayer services.⁵¹ Conducting research in this area should be a top priority, elevating it to the same academic and econometric level that has hitherto been afforded largely just to the revenue windfalls from conventional “enforcement” approaches. Commissioning such research now, perhaps using instructive language in IRS appropriations bills, would pay major dividends in the near future as IRS compliance strategies move from planning to execution.

⁴⁶ Cited in Sepp, Pete. “Comments before the Subcommittee on Oversight, Committee on Ways and Means, IRS Reform: Resolving Tax Disputes,” September 13, 2017. <https://www.ntu.org/publications/detail/irs-reform-resolving-taxpayer-disputes>.

⁴⁷ The full joint research conference proceedings may be viewed online at <https://www.taxpolicycenter.org/event/12th-annual-irstpc-joint-research-conference-tax-administration>.

⁴⁸ The full joint research conference proceedings may be viewed online at <https://www.taxpolicycenter.org/event/11th-annual-irstpc-joint-research-conference-tax-administration>.

⁴⁹ See, for example, Wilford, Andrew. “Tax ‘Shame Lists’: 19 States Publish Private Info about Taxpayers.” National Taxpayers Union Foundation. April 19, 2023. <https://www.ntu.org/foundation/detail/tax-shame-lists-why-19-states-publish-private-info-about-taxpayers>.

⁵⁰ The full “Tax Chat!” to which this paragraph refers may be viewed online at <https://www.youtube.com/watch?v=DR01e0vWRmY>.

⁵¹ The full Lubick Symposium to which this paragraph refers may be viewed online at <https://www.taxpolicycenter.org/event/how-does-irs-intend-invest-80-billion-over-next-decade>.

In addition, as witness Chris Edwards observed, solid research on the “cost” part of “cost-benefit analysis” associated with various compliance approaches is sorely needed.

As an example, for many years, National Taxpayers Union Foundation has published an annual analysis of Federal personal and business income tax system complexity, including estimates of paperwork burden hours based on Office of Information and Regulatory Affairs (OIRA) data.⁵² Two findings from recent studies are that many of OIRA’s “information collections” are based on very scant responses from taxpayers⁵³ and that online reports are less than transparent:

One simple way to improve transparency would be to separate information collections that have no actual cost from those where the cost is indeterminate. This way, users of the data would not have to wade through successive pages and attached Supporting Statements to find that out. The information on OIRA’s paperwork burden database should specify that a cost is indeterminate instead of listing it as \$0.⁵⁴

It should be noted that the Foundation’s paperwork burden estimates (6.5 billion hours and \$260 billion) for individual and business filers do not include compliance costs associated with IRS subregulatory guidance. This type of tax compliance needs to be measured and made public.

Even with measurements that have more interest from researchers, the principle of competition could be brought to bear in encouraging more innovative, fresh approaches. After all, TIGTA recently pointed out improvements that are needed at the IRS’s Office of Research, Applied Analytics, and Statistics (RAAS) for tax gap estimates:

RAAS does not have documented policies or procedures for producing the Tax Gap estimates. While the IRS has high-level quality and research guidelines, they do not discuss the Tax Gap estimates. In lieu of documented procedures, RAAS has developed technical papers for each component of the Tax Gap estimates, which provide varying levels of specificity on the data sources and methodologies used. In addition, RAAS does not have written policies, procedures, or guidance to 1) specify the frequency of issuing Tax Gap estimates or 2) help RAAS analysts meet internal milestones for developing the Tax Gap estimates. Instead, RAAS relies on its staff’s experience with developing previous Tax Gap estimates to meet internal milestones. This raises concerns about the potential for a lapse in quality, timeliness, and continuity of operations following an unexpected departure of subject matter expert(s).⁵⁵

Other Federal agencies, such as CBO, the Joint Committee on Taxation, the Small Business Administration, and others can and should be invited more regularly to share their experience and expertise on tax compliance matters. So should private sector associations and econometric firms. A well-functioning IRS Oversight Board, in conjunction with IRSAC, could easily provide the ongoing direction to coordinate this activity.

(6) “TAX CERTAINTY” BEGINS WITH FOLLOWING NOTICE AND COMMENT PROCEDURES

NTU applauds the Strategic Operating Plan’s emphasis on providing guidance and certainty to taxpayers, including revision of notices “by simplifying the language,” “increasing the current rate from five to seven notices per year to as many as 500 per year,” “develop[ing] additional, tailored tax certainty programs,” and

⁵² See, for example, Brady, Demian. “6.5 Billion Hours, \$260 Billion: What Tax Complexity Costs Americans.” National Taxpayers Union Foundation. April 17, 2023. <https://www.ntu.org/foundation/detail/65-billion-hours-260-billion-what-tax-complexity-costs-for-americans>.

⁵³ Brady, Demian. “Increasing Complexity Brings Back Bigger Compliance Burdens.” National Taxpayers Union Foundation, April 18, 2022. <https://www.ntu.org/foundation/detail/increasing-complexity-brings-back-bigger-compliance-burdens>.

⁵⁴ Brady, Demian. “6.5 Billion Hours, \$260 Billion: What Tax Complexity Costs Americans.” National Taxpayers Union Foundation. April 17, 2023. <https://www.ntu.org/foundation/detail/65-billion-hours-260-billion-what-tax-complexity-costs-for-americans>.

⁵⁵ Rascon, Jose. “IRS Lacks a Clear Estimate of Uncollected Taxes, Watchdog Says.” Meritalk, March 31, 2023. <https://www.meritalk.com/articles/irs-lacks-a-clear-estimate-of-uncollected-taxes-watchdog-says/>.

growing “capacity for addressing taxpayer issues through guidance interpreting the tax law.”⁵⁶

These efforts would have much more credibility if Congress or the courts were to affirm that the IRS must follow the Administrative Procedure Act requiring that “agency decisions be made only after affording interested persons notice and opportunity to comment.”

My colleague at NTU Foundation, Joe Bishop-Henchman, recently explained:

The IRS and the Treasury Department do not follow APA procedures for most of the hundreds of official changes they make annually to how they enforce the tax code, “having claimed for several decades that their rules and regulations are exempt from those requirements.” They characterize APA directives as merely interpretive, not legally binding, and therefore they are not subject to the APA. But even when the Treasury Department has initiated a formal notice-and-comment rulemaking process, it often skips steps. In more than 36 percent of cases, it made the proposed rule legally binding before accepting any comments, and in nearly 5 percent of cases, it skipped accepting comments and simply adopted the final rule.

It is no accident that the IRS set up a situation where it claimed its one-sided and burdensome regulation was both exempt from the APA process and unable to be challenged because of the Anti-Injunction Act, or that the IRS can take months to respond to taxpayers, but taxpayers automatically lose if they take even 1 extra day to respond. The *CIC Services* and *Boechler* decisions chip away at defenses that the IRS has often used to insulate its subregulatory “guidance” from legal challenge. But there still has not been a congressional or judicial declaration that the IRS must follow the APA. Until that happens, the IRS enjoys, as six Federal judges observed in 2011, “a world in which no challenge to its actions is ever outside the closed loop of its taxing authority.”⁵⁷

The Service can also do more to clarify for taxpayers the degree to which they may rely on subregulatory guidance such as the Internal Revenue Bulletin, Revenue Procedures, and Technical Advice Memorandums. Furthermore, the “Job Aid” process, which involves practitioners more thoroughly in the mechanics of compliance with complex issues should be amplified.⁵⁸

(7) TAX SIMPLIFICATION: THE “BROKEN RECORD” THAT KEEPS PLAYING

No other single item in NTU’s testimonies on tax administration over past decades has made the “top 10” list of recommendations than the need to simplify the tax laws. While we are well aware that this task is often extolled but rarely practiced, we once again offer some practical first steps.

Section 4022 (a) of RRA 98 required the IRS to produce an annual report to Congress on “sources of complexity in the administration of the Federal tax laws.” The provision was successful, even though IRS compliance with it was limited. According to the National Taxpayer Advocate, the tax agency has issued just two annual reports compliant with the 1998 statute, but in both instances, “Congress adopted legislation to address each area of complexity referenced in the reports, and the IRS addressed the administrative problems they uncovered. Thus, the IRS’s decision to discontinue the reports has likely contributed to tax complexity.” The last report was published in 2002; Congress should order resumption of the annual reports now.

NTU also concurs with the Taxpayer Advocate’s recommendation that “the IRS establish a process to automatically provide the tax writing committee staff with a list of specific front-line technical experts who can discuss the administrability of pending (or existing) legislation directly with the tax-writing committees,” as provided in section 4021 of RRA 98. The most important results would be in budgetary savings to the IRS and reduced private-sector compliance costs—a win-win situation for taxpayers.

⁵⁶ IRS, (April 2023). “Internal Revenue Service Inflation Reduction Act Strategic Operating Plan: FY 2023–2031,” pp. 52–54. Retrieved from: <https://www.irs.gov/pub/irs-pdf/p3744.pdf> (accessed May 11, 2023).

⁵⁷ Bishop-Henchman, Joseph. “Transforming the Internal Revenue Service.” Cato Institute Policy Analysis No. 942. April 11, 2023, p. 7. <https://www.cato.org/policy-analysis/transforming-internal-revenue-service>.

⁵⁸ See, as an example, Sepp, Pete. “IRS Considering Backdoor Death Tax Hike.” Comments to Internal Revenue Service re: Docket ID: IRS-REG-163113-02, RIN 1545-BB71. November 2, 2016. <https://www.ntu.org/publications/detail/irs-considering-backdoor-death-tax-hike>.

Furthermore, the need for a regular review of the tax laws with an eye toward clearing away unnecessary, conflicting, or cumbersome provisions will always be extant. NTU's staff recalls vividly from field hearings and other submissions to the Commission that many members of the private-sector tax community were willing to volunteer substantial time and energy to make suggestions for simplification. A panel, meeting once every 4 years, would harness this volunteer activity.

There are several models for a process such as this, among them the creation of an executive branch body (*e.g.*, via the Federal Advisory Committee Act). Its mission: to evaluate title 26 of the U.S. Code and title 26 of the Code of Federal Regulations in order to methodically identify specific opportunities for simplification, clarification, and repeal of provisions that are complex, contradictory, difficult to administer, or outdated, and provide actionable recommendations that the executive and legislative branches can implement in expedited fashion.

Members would include individual taxpayers, business taxpayers, tax practitioners, tax attorneys, academics, and former public officials with an expertise in tax administration (subject to Federal employment rules). The Commission's management could be drawn from the National Taxpayer Advocate's Office, the IRS Oversight Board, IRSAC, ETAAC, or the Treasury Inspector General for Tax Administration. Participation and consultation of congressional staff would be invited and encouraged. The Commission's report could be partitioned according to those requiring legislative action and those necessitating executive action. In order to precipitate such action, the legislative portion could be required by law to be received by the tax-writing committees and brought to the floor under privileged consideration. The executive portion could be automatically referred to the rulemaking process under APA.

The preceding outline would require additional details. As we have been for 25 years, NTU is ready and willing to assist in developing the charter for this Commission.

(8) SECURE THE SERVICE'S IT CAPACITY BEFORE LAUNCHING AMBITIOUS CYBER-COMPLIANCE PLANS

At the Donald C. Lubick Symposium mentioned earlier, former Commissioner Charles Rossotti mentioned the need to "go slow" when ramping up new compliance strategies.⁵⁹ One area where NTU believes the IRS must indeed learn to walk before it runs is on the Information Technology track.

By now, every member of this committee is well aware of the Service's IT problems with customer service, and all of us hope that Commissioner Werfel's ambitious goal of completely revising the interoperability of the Individual Master File by 2028.⁶⁰ Although the Service's IT operations have certainly benefited from the leadership of Chief Information Officer (CIO) Sieger and hopefully from Acting CIO King, as the Government Accountability Office recently pointed out in February of this year, "[a]s of August 2022, the IRS had 21 modernization initiatives, including 9 to replace its outdated IT systems. However, 6 of those 9 initiatives did not specify how they would dispose of outdated systems—a key element in IT modernization."⁶¹ This is but one of many challenges on the road ahead.

Still, there are many areas of IT at the Service outside of taxpayer-facing platforms that will need to be updated . . . and none will require greater operational security than those platforms that will be designed for compliance research and data-gathering purposes. The Department of Justice has recently announced the formation of a Digital Asset Coordination Network to "combat the growing threat posed by the illicit use of digital assets to the American public."⁶² Digital assets are a key focus of the IRS as well as IRA supporters who see opportunities for revenue enhancement through increased compliance funding.

⁵⁹The full Lubick Symposium to which this paragraph refers may be viewed online at <https://www.taxpolicycenter.org/event/how-does-irs-intend-invest-80-billion-over-next-decade>.

⁶⁰Rascon, Jose. "IRS Chief Aiming for Individual Master File Update by 2028." Meritalk, April 20, 2023. <https://www.meritalk.com/articles/irs-chief-aiming-for-individual-master-file-update-by-2028/>.

⁶¹U.S. Government Accountability Office. "Information Technology: IRS Needs to Complete Modernization Plans and Fully Address Cloud Computing Requirements." GAO-23-104719, January 12, 2023. <https://www.gao.gov/products/gao-23-104719>.

⁶²U.S. Department of Justice. "Justice Department Announces Report on Digital Assets and Launches Nationwide Network." September 16, 2022. <https://www.justice.gov/opa/pr/justice-department-announces-report-digital-assets-and-launches-nationwide-network>.

Aside from the fact that international criminals are notoriously difficult targets for tax compliance efforts, the fact that the IRS will be “fishing in the pond” of digital assets more often means that cybersecurity will take on special importance. Even if the Service is interested primarily in compliance from those who aren’t running criminal schemes but are simply failing to properly pay taxes on legitimate digital asset transactions, the Service will be casting a wide net. Caught in that net will likely be some of the most skilled online malefactors in the world. The IRS must be prepared for *anything* to happen from these interactions. A breach of the Service’s IT systems could become a portal through which criminals or even bad-actor states could compromise our entire national security.

Furthermore, while technology is an important driver in enhancing taxpayer service and compliance, it is not without risks to both objectives. During a recent Tax Policy Center webinar entitled “Can Machine Learning Improve Tax Enforcement?” Alex Engler of the Brookings Institution expressed support for the IRS’s direction of its 5-year-old machine learning techniques for detecting noncompliance but cautioned that the technology should be carefully monitored. As he explained, AI could improperly identify certain taxpayers for examination or enforcement, thus depriving them of certain deductions or credits. Some of the challenges to AI functioning properly in this area are that algorithms may be based on prior taxpayer case records, delays in court cases make “fresh” data problematic, and the shifting tax laws present a challenge to modeling. Also, parts of the tax code are very complicated, open to different interpretations and ambiguity.⁶³

The Strategic Operating Plan’s commitment to “[continue to implement best practices in cybersecurity]” is laudable, but given recent evaluations, much remains to be done. Last year, TIGTA found that the IRS failed to meet 17 of 20 “Core Inspector General Metrics” established for cybersecurity government-wide.⁶⁴ In addition to taxpayer services, cybersecurity must be a foundational priority for the Service before other initiatives can move forward. Congress must provide firm guidance to the IRS during the appropriations process to ensure both these ends are adequately funded out of existing resources.

(9) PLAN FOR HEARINGS ON OTHER APPROACHES TO IMPROVING COMPLIANCE, INCLUDING ACCESS TO COURTS AND TRUE “COMMUNITY ENGAGEMENT”

NTU continues to believe that as with any other area of compliance with laws, tax compliance benefits from the existence of safeguards to Americans’ fundamental rights. When citizens feel that everyone will get a “fair shake” from examinations, collections, appeals, jurisprudence, and other aspects of tax administration, they will more readily respect and follow the laws of the system. With so many compliance resources flowing to the IRS, the committee could plan ahead.

Although the 1988 and 1998 taxpayer rights laws provided for certain exceptions, taxpayers still generally cannot enforce their rights in court until after they have been violated. Under section 7421 of the Internal Revenue Code, no lawsuit can be brought by any person in any court for the purpose of restraining the assessment or collection of a tax, except under limited circumstances.

The case law around the Anti-Injunction Act further impedes the ability to restrain the collection of the tax. In theory, injunctions can be granted where the failure to grant relief would result in irreparable damage to the taxpayer, but in practice, this provision is virtually unusable. With the more recent *CIC Services* decision, the IRS can no longer hide behind the Act for every reason, such as penalty determinations. Nonetheless, the Declaratory Relief Act, which allows citizens to file a suit that can persuade a court to declare their rights, indicates that the law applies “except with respect to Federal taxes.” The Federal Tort Claims Act presents additional barriers to tax-related controversies.

Congress should give serious consideration to providing citizens with the limited ability to stop the IRS from violating their rights through litigation. Doing so will involve some level of controversy, and will no doubt prompt lengthy deliberation. As a starting point, my colleague Joe Bishop-Henchman has suggested “narrowing the Anti-Injunction Act to limit only preliminary or temporary injunctions.” Another ap-

⁶³ See Tax Policy Center, Urban Institute Webinar. “Can Machine Learning Improve Tax Enforcement?” 2022. The entire webinar to which this paragraph refers may be viewed online at <https://www.youtube.com/watch?v=fIZYd3o7wJQ>.

⁶⁴ Gaetano, Chris. “TIGTA: IRS Cybersecurity Falls Short on 17 of 20 Metrics.” *Accounting Today*, July 21, 2022. <https://www.accountingtoday.com/news/tigta-irs-cybersecurity-programs-not-effective-falls-short-on-17-of-20-metrics>.

proach might be for Congress to re-codify the 10 taxpayer rights in the Protecting Americans from Tax Hikes Act of 2015 so that the rights may be invoked in actual disputes, instead of “mere suggestion[s] for IRS employees that they can safely ignore.”⁶⁵

Besides weightier issues such as these, during markup of a version of the Taxpayer First Act in 2018, NTU offered suggestions to improve the taxpayer experience in Tax Court. Several Tax Court officials, including Chief Special Trial Judge Peter Panuthos, have been contemplating a shift in the Court’s role to provide a fairer venue for taxpayers. At a 2017 International Conference on Taxpayer Rights, Judge Panuthos of the Court provided a truly compassionate (and in his case customary) view of his role, in discussing how he thought the Court might be able to engage in “affirmative judging.”

Andy Roberson of McDermott Will and Emery wrote:

Drawing on a report by a law school professor, Judge Panuthos discussed whether judges should follow the “passive norm”—just call “balls and strikes,”—or engage in affirmative judging (*i.e.*, assisting taxpayers by asking questions and being more involved in the process). The discussion was very interesting, particularly with the point being made that in complex cases such as transfer pricing, judges routinely have conference calls with the parties and are actively engaged in trying to narrow the issues and get the parties to agree on what is really at issue.⁶⁶

Five years ago, the Tax Court’s Judicial Conference discussed several changes to procedures that Congress ought to encourage:

- Codification of how amicus briefs can be filed in Tax Court cases. Currently individual Tax Court judges have discretion over how and where they are accepted.
- Availability of more Tax Court documents (such as filings, not just decisions) online to the public, not just to litigants or those who are able to visit the Tax Court’s facility in Washington, DC. Appropriate privacy guidelines, especially for pro se taxpayers, would be necessary.
- Clearer and more consistent notices for non-party subpoenas.⁶⁷

The committee could be very helpful by formulating legislative language either directing the Tax Court to develop these procedures or expressing the Sense of Congress that the Tax Court should do so.

NTU wishes to remind committee members in recognition of this hearing’s title, that for many years traditional “law enforcement” oversight mechanisms have been discussed for the IRS as well. One was brought to the attention of the Restructuring Commission during its Omaha, NE field hearing on April 4, 1997. During those proceedings, Samuel Walker, a Professor of Criminal Justice at the University of Nebraska-Omaha, offered a proposal for an IRS citizen review board. This office, modeled after citizen review and complaint entities established in many cities for police departments, would not be charged with resolving tax administration problems (the mission of the National Taxpayer Advocate) or allegations of criminal behavior (investigated through the Inspector General or the Department of Justice). Rather, it would hear taxpayer concerns over specific instances of mistreatment by IRS personnel and make recommendations for disciplinary action.

Walker outlined a structure whereby an External Independent Complaint Auditor, appointed in consultation with Congress, would oversee an Internal Office of Citizen Complaints to receive specific reports from citizens and, summarize annually any changes to personnel procedures that might help to minimize incidents and complaints in the future. The Restructuring Commission’s final report proposed, instead, that the IRS should “centralize the cataloging and review of taxpayer complaints of IRS misconduct on an individual employee basis.” This advice, subsequently embedded in RRA 98, has failed to provide a more formalized grievance procedure which, along with regular reporting on personnel remedies that a citizen re-

⁶⁵ Bishop-Henchman, Joseph. “Transforming the Internal Revenue Service.” Cato Institute Policy Analysis No. 942. April 11, 2023, p. 12. <https://www.cato.org/policy-analysis/transforming-internal-revenue-service>.

⁶⁶ Cited in Sepp, Pete. “Comments on the Taxpayer First Act to the Honorable Lynn Jenkins and the Honorable John Lewis.” April 4, 2018.

⁶⁷ *Ibid.*

view board can provide, could result in more productive resolution of disciplinary problems among tax agency employees.

Congress could request a study from the IRS Oversight Board or National Taxpayer Advocate to evaluate the experiences of city police department complaint entities since 1997, and explore the suitability of updating Walker's proposal to current circumstances with the Strategic Operating Plan.⁶⁸

There are many other aspirational proposals we would gladly raise with committee members. The ones outlined here would plainly require bipartisan alignment that would need to take place over a potentially lengthy period of time. Nonetheless, it will pay—literally—to think ahead about proposals such as these, while the committee concentrates on near-term goals such as those articulated in legislative form below.

(10) WORK ON BIPARTISAN LEGISLATION FOR MUCH-NEEDED
REFORMS TO TAX ADMINISTRATION

Despite recent, and at times heated, political rhetoric over the IRS and the \$80 billion funding infusion provided to the agency by the IRA, lawmakers in both parties continue to work together on legislation that would improve tax administration. Doing so would foster a spirit of cooperation that could make all of the nine recommendations above less difficult to confront.

Last month, NTU was proud to support the Taxpayer Advocate Enhancement Act, introduced by Senators Ben Cardin (D-MD) and Bill Cassidy (R-LA) in the Senate (S. 1283)⁶⁹ and Rep. Randy Feenstra (R-IA) and four bipartisan cosponsors in the House (H.R. 2755).⁷⁰ This legislation would allow the National Taxpayer Advocate (NTA) to appoint her own counsel, enhancing the independence of the Office of the Taxpayer Advocate and improving the NTA's ability to provide sound, sensible, and nonpartisan recommendations on tax administration policy. NTU has supported allowing the NTA to hire her own counsel for years, since former NTA Nina Olson first included the recommendation in the annual "Purple Book."⁷¹

Last month we also supported the Cutting Paperwork for Taxpayers Act (H.R. 2978),⁷² introduced by Reps. Abigail Spanberger (D-VA) and Young Kim (R-CA). This common-sense legislation would prevent taxpayers receiving a late refund from the IRS from then also having to pay taxes on the interest they justly receive for the agency's delays.

Bipartisan legislation introduced earlier in the 118th Congress by Senators Chuck Grassley (R-IA) and Chair Wyden (D-OR) in the Senate, and Rep. Mike Kelly (R-PA) in the House, would significantly enhance whistleblower protections at the IRS. This important bill, the IRS Whistleblower Program Improvement Act (S. 625, H.R. 1300),⁷³ dovetails with two critical and long-running initiatives advanced by NTU: improving Federal tax administration and enhancing Federal protections for courageous individuals blowing the whistle on wasteful spending or abuse of power within the government.

⁶⁸For background *see*, Sepp, Pete. "Comments before the Subcommittee on Oversight, Committee on Ways and Means, 'IRS Reform: Resolving Tax Disputes,'" September 13, 2017. <https://www.ntu.org/publications/detail/irs-reform-resolving-taxpayer-disputes>.

⁶⁹Congress.gov. "S. 1283—Taxpayer Advocate Enhancement Act." Introduced April 25, 2023. Retrieved from: <https://www.congress.gov/bill/118th-congress/senate-bill/1283> (accessed May 11, 2023).

⁷⁰Congress.gov. "H.R. 2755—National Taxpayer Advocate Enhancement Act of 2023." Introduced April 20, 2023. Retrieved from: <https://www.congress.gov/bill/118th-congress/house-bill/2755> (accessed May 11, 2023).

⁷¹For the latest Purple Book, released in January 2023, *see* Taxpayer Advocate Service. "National Taxpayer Advocate 2023 Purple Book." January 2023. Retrieved from: <https://www.taxpayeradvocate.irs.gov/reports/2022-annual-report-to-congress/national-taxpayer-advocate-2023-purple-book/> (accessed May 11, 2023).

⁷²Congress.gov. "H.R. 2978—Cutting Paperwork for Taxpayers Act." Introduced April 27, 2023. Retrieved from: <https://www.congress.gov/bill/118th-congress/house-bill/2978> (accessed May 11, 2023).

⁷³Congress.gov. "S. 625—IRS Whistleblower Program Improvement Act of 2023." Introduced March 2, 2023. Retrieved from: <https://www.congress.gov/bill/118th-congress/senate-bill/625> (accessed May 11, 2023); Congress.gov. "H.R. 1300—IRS Whistleblower Program Improvement Act of 2023." Introduced March 1, 2023. Retrieved from: <https://www.congress.gov/bill/118th-congress/house-bill/1300> (accessed May 11, 2023).

Another bipartisan bill introduced in the current session of Congress, the Electronic Communication Uniformity Act (S. 1338)⁷⁴ from Senators Marsha Blackburn (R-TN) and Catherine Cortez Masto (D-NV), would “[provide] that such documents and payments [submitted electronically to the IRS by taxpayers] shall be deemed filed or made on the date on which they are sent electronically, regardless of the date on which the IRS actually receives or reviews them.” This legislation would establish parity between electronic and paper filings, a recommendation NTU called for in an April 2022 written submission to this committee.⁷⁵

In summary, there is no shortage of productive, constructive, and bipartisan bills for this committee to consider in the months ahead that could reform IRS procedures and processes and improve tax administration as the agency embarks on spending up to \$80 billion in supplemental funding over the next 10 years. There may be little to no agreement among the two parties over whether to keep or rescind the supplemental funding provided to the IRS by the IRA, and there may be even less agreement over how much supplemental funding may yield additional revenues for the Treasury, but there are plenty of areas of agreement that would improve the IRS and the taxpayer experience with the agency.

AT YOUR SERVICE: THE TAXPAYERS FIRST PROJECT

Asking policymakers from many perspectives to work together, as this testimony does, is easier said than done. Nonetheless, perhaps the committee can draw some encouragement from a recent undertaking by the National Taxpayers Union Foundation.

Taxpayers for IRS Transformation (Taxpayers FIRST) is designed to convene an expert group of non-governmental stakeholders with a diverse set of backgrounds and perspectives to offer guidance to the IRS as it plans to spend the most significant infusion of funding it has ever received. The Project aims to assist IRS officials and policymakers so that the new funding is spent effectively, improves taxpayer services, upgrades outdated technology, and helps efficiently reduce the tax gap while respecting and strengthening taxpayer rights and due process.⁷⁶ These experts include:

- Nina Olson, former National Taxpayer Advocate.
- Fred Goldberg, former Commissioner of the IRS.
- Caroline Bruckner, managing director of the Kogod Tax Policy Center.
- Jason Fichtner, vice president and chief economist at Bipartisan Policy Center.
- Jeff Trinca, former tax counsel for Senator David Pryor (D-AR) and currently founding vice president with Van Scoyoc Associates.
- Janet Holtzblatt, senior fellow at the Urban-Brookings Tax Policy Center.
- Erica York, senior economist at Tax Foundation.
- Renell Dubay, Kay Perrone and Associates.
- Gordon Gray, director of fiscal policy at American Action Forum.
- Fred Forman, former IRS Associate Commissioner of Business Systems Modernization.
- Jason DeCuir, partner at Advantous Consulting.
- Adam Michel, former Deputy Staff Director of the Joint Economic Committee and current director of tax policy at Cato Institute.
- Barbara Robles, former principal economist at the Federal Reserve Board of Governors as well as the Joint Committee on Taxation and former tax examiner for the IRS.
- Alex Brill, senior fellow at American Enterprise Institute.
- Peter Mills, senior manager of tax policy at AICPA.
- Rebecca Thompson, vice president of strategic partnerships and network building at ProsperityNow.

These individuals, joined by leaders from the National Association of Enrolled Agents and more to follow, will be conducting many consultative sessions this year

⁷⁴ *Congress.gov*. “S. 1338—Electronic Communication Uniformity Act.” Introduced April 27, 2023. Retrieved from: <https://www.congress.gov/bills/118th-congress/senate-bill/1338> (accessed May 11, 2023).

⁷⁵ Sepp, Pete; and Lautz, Andrew. “NTU Submits IRS Reform Recommendations Ahead of Agency’s Budget Hearing.” NTU, April 7, 2022. Retrieved from: <https://www.ntu.org/publications/detail/ntu-submits-irs-reform-recommendations-ahead-of-agencys-budget-hearing> (accessed May 11, 2023).

⁷⁶ For further information and updates in the Taxpayer FIRST project’s activities, please visit www.taxpayers-first.org.

on matters such as measuring the tax gap, improvements to customer service, modernization, and protection of taxpayer rights and privacy. Taxpayers FIRST will be presenting its recommendations in reports to be released at public events into 2024.

The National Taxpayers Union Foundation has been able to initiate Taxpayers FIRST in part to serve as a resource to policymakers who are earnestly seeking solutions to many of the challenges facing the IRS's future success. This panel of experts, which will add members over time, will be available on tax administration matters at any point in time. Please consider Taxpayers FIRST to be an advisor in the committee's work.

CONCLUSION

How do organizations execute successful transformations? This is the central question subsequent to the enactment of \$80 billion of additional funding for the IRS. In my opinion, such transformations, whether in the private or public sectors, come from several sources.

- **From employees.** Private companies, on occasion, are prompted to change through their workforces. IRS workers proved to be key in advising the National Commission on Restructuring the IRS, as well as this committee during the deliberations over RRA 98. They were able to identify leadership, personnel policy, and structural issues that were standing in the way of success for the Service's next chapter. So far, Congress has heard little from Service employees about the Strategic Operating Plan.
- **From customers.** Private-sector actors are under constant pressure to innovate and deliver, at the risk of losing customers. To be frank, taxpayers can't choose which IRS to use, and therefore are not "customers" in the conventional sense. They can only exert a modest degree of influence over the way the Service operates by volunteering for IRSAC, ETAAC, the Taxpayer Advisory Panels, and occasionally, through litigation.
- **From competitors.** Loss of market share from firms that provide a product faster, cheaper, and better often incentivizes private-sector companies to keep innovating or fade away. Here again, except for a few Americans who take the drastic step of renouncing citizenship, the IRS has no "competitor" at the Federal level. "Patriotic" or not, companies and individuals abroad seeking to invest in the United States, as well as those already here who are contemplating expansion, can evaluate whether tax administration climates elsewhere in the world are more hospitable.
- **From shareholders.** This group is a fulcrum of leverage that can often change the entire direction of a private company. Alas, there is not a direct equivalent in government, save the voters, who get to speak more on the general path of government than specific issues like IRS management.
- **From boards of directors and others.** Many private-sector companies are reoriented in a more productive direction by positive action from boards of directors and other entities that are outside the day-to-day management structure. So it must be with the IRS—a functioning Oversight Board, along with IRSAC, ETAAC, TAPs, Congress, and institutions outside government such as Taxpayers FIRST, and many, many more institutions yet to weigh in, can have a role in a transformation for which all Americans have a stake.

This testimony has been broken into sections using the theme of "realities," no doubt leading some to wonder whether the recommendations above are realistic themselves. The answer is, they have to be. No, activities such as rebalancing the role of the courts, or imposing a tax simplification process, can happen overnight. But other steps, such as reconstituting the IRS Oversight Board and evaluating the IRA funding mix, can and should happen now.

Each item in these recommendations may have its own timetable, *but several are well within the grasp of this Congress, this year.* For the sake of all taxpayers, let us move forward.

I am most grateful to all of you for engaging in this hearing and for devoting so much attention to these lengthy remarks.

QUESTIONS SUBMITTED FOR THE RECORD TO PETE SEPP

QUESTION SUBMITTED BY HON. CATHERINE CORTEZ MASTO

Question. Taxation in Indian Country is unnecessarily complex and hinders economic development in areas that need it most. Often, the reason for the complexity is that Tribal Governments are not always consulted when Federal tax legislation is being drafted or during the regulatory process. As a result, Tribal Governments do not have access to the same economic development tools as State and local governments; this only exacerbates the health, education, and financial disparities in Native American communities.

In your testimony you talk about the need to focus on compliance and to use existing assets for management. My office is working with Tribal stakeholders to support the advancement of American Indian and Alaska Native communities and foster economic opportunities, but there needs to be Tribal consultation when it comes to compliance.

Can you discuss how the IRS can bring Tribes to the table to ensure compliance? How can more resources help outreach?

Answer. Historically the IRS has tended to undervalue proactive (and preventative) stakeholder and taxpayer outreach and consultation as tools to encourage compliance. They are often at the front of the line for budgetary reductions when the Service is strapped for funds. For example, there are currently no IRS Taxpayer Assistance Centers overseas for Americans living abroad, while only recently have the TACs been better staffed in Puerto Rico, a U.S. territory. The new IRA funding should prioritize services like these, which aid in compliance on the front end, before pouring billions more dollars into “enforcement” for post-filing scenarios, which are much costlier on a per-case basis.

The problem is far worse with Tribal stakeholders. A common misconception is that all economic activities of Tribes and their members are federally tax-exempt, when in reality the situation is much more complicated—especially for individual Tribal members. Maladministration of the tax laws, or a poor understanding of the Service’s part of how Tribal Governments and their members actually function economically, can lead to lost opportunities for growth and prosperity.

I fully agree with your concerns and would recommend the following steps to help ease the problems arising from tax complexity’s impact on American Indian and Alaska Native communities:

- (1) H.R. 2676, the IRS Restructuring and Reform Act of 1998, required a Tax Complexity Analysis of legislation affecting large numbers of individuals or businesses as it moved through Congress. Unfortunately, this provision has often been waived. I would suggest modifying this section of H.R. 2676 (section 4022 (b)) to allow a member of the Senate Finance or House Ways and Means Committee to request a tax complexity analysis from JCT and IRS for any bill brought before the committee. This could allow a member to generate early discussion on the impact of a given tax bill on Tribal Governments and members.
- (2) Provide for regular meetings of the IRS Taxpayer Advocacy Panels on a rotating basis in American Indian and Alaska Native Communities, in order to obtain practical recommendations for the design of publications and tax returns for Tribal members.
- (3) Request that GAO, the National Taxpayer Advocate, and the IRS Advisory Council consult directly with Tribal Governments to catalog the sources of complexity, confusion, and frustration that Tribal Governments have experienced due to lack of consultation over the design of Federal tax laws. This collection of information could allow the Treasury’s Office of Tribal Affairs as well as appropriate committees in Congress to work together in addressing the worst areas of complexity.

All these initiatives would require greater funding, but the investment would be worthwhile.

QUESTIONS SUBMITTED BY HON. TODD YOUNG

Question. One premise of this hearing is that if the House-passed Limit, Save, Grow Act of 2023 were to become law, none of the taxpayer services improvements at the IRS would have taken place or could be sustained. Is this true?

Answer. While the Limit, Save, and Grow Act would certainly curtail and restrict the growth of IRS funding, choices could still be made within those funding levels to prioritize taxpayer services. By most accounts, the IRS will have spent somewhere in excess of \$500 million of IRS funding on taxpayer service improvements by June 30, 2023. I believe this expenditure certainly is having palpable, salutary effects on the taxpayer experience in contacting and interacting with the IRS. It was a wise investment, not only for building goodwill in the tax filing population but also for aiding compliance with tax laws (a far less expensive way to enforce the laws compared to audits and other post-filing activities). A \$500+ million shift of funding toward taxpayer services could be accommodated under the Limit, Save, and Grow Act. However, I would also contend that for longer-term improvements in the way the Service operates, additional funds, potentially beyond those that the Limit, Save, and Grow Act, could be desirable *if accompanied by proper reforms and guard rails*. I believe it is particularly important to acknowledge the need for multiyear capital expenditures to finally embark on the urgently needed Business Systems Modernization at the Service. Without a successful, timely, and well-overseen BSM, none of the goals that Republicans or Democrats on the committee have for the IRS—whether customer service improvements, respect for taxpayer rights, or even stricter compliance—can be reached. Whether effectuated by additional funding, shifts in funding, or a combination thereof, this is the one critical piece on which Congress should focus.

Question. In your experience, what have been the key ingredients in past IRS transformation bills that have made success for taxpayers likelier?

Answer. Every successful IRS transformation effort has, in my opinion, shared several elements:

- (1) Detailed strategic planning that sets specific objectives and timelines (see the Taxpayer First Act report to Congress) rather than repetitive aspirations that later become obfuscated (see the Strategic Operating Plan);
- (2) Ongoing guidance from experts outside the IRS and Congress that can provide day-to-day consultation on the implementation of strategic planning (e.g., the IRS Oversight Board created in the IRS Restructuring and Reform Act of 1998, now dormant due to lack of a quorum of members);
- (3) Consistent “feedback loops” that allowed periodic course corrections from Congress to reach objectives of reform (e.g., Taxpayer Bill of Rights of 1998, “T2” of 1996, and RRA of 1998).
- (4) A focus on transforming first, rather than the need to hit some specific revenue target. Prior to the infusion of funds from IRA, no other legislation purporting to have serious intentions of changing direction at the IRS was so driven by “the score.” Lawmakers all recognized the revenue impacts of the IRS reform legislation they were proposing, but the priority was to set the proper stage for success, from which revenues would eventually flow.

Question. Do you believe that the \$15 million in Inflation Reduction Act (IRA) funding to study the feasibility of a government-run filing and tax preparation portal was a wise use of resources?

Should the development of this portal be a priority program for the IRS?

Answer. As I mentioned earlier, Business Systems Modernization must be the sole, strongest focus of time, talent, and resources at IRS. The development of the Direct File portal represented the polar opposite of what the Service should have been doing in the area of technological improvement. NTU has supported the public-private consortium known as Free File, while acknowledging the need for evolving that partnership into one that can serve even more taxpayers with private-sector driven innovation. Direct File was a diversion of resources at a critical point in the Service’s plans for modernization, not to mention a contravention of the statutory language’s intent that the Service develop only a study rather than an actual system. This is an example of misplaced priorities.

Question. How much of recent improvements at IRS—such as answering phones and processing returns—are due to the end of pandemic-related workplace and managerial procedures versus new funding from IRA?

Answer. This is a difficult question to answer, precisely because many of the measurements the IRS should have been taking during the pandemic were never done. Nonetheless, there are some clues that fall-offs in certain needs among the tax filing population may be driving at least some of the improvements in customer service. As an example to your point, Senator, GAO has reported that in 2023 the IRS answered 7.7 million calls versus 4.6 million in 2022. Yet, the response rate

that IRS officials have touted is tremendously impacted by the fact that far fewer taxpayers contacted the IRS in 2023 than in 2022 (25.9 million versus 63.7 million). Much of this is due to the expiration of pandemic-era tax relief programs. Furthermore, the Service does not report on the outcomes of all its calls. How many calls, once answered, provided the help the taxpayer needed, as opposed to the taxpayer being told their question was “out of scope” and that they should consult a tax advisor instead. The need to develop better metrics of the *relative* volume of service, as well as the quality of service, remains apparent, and is one topic of study for the advisory board of our research arm’s Taxpayers FIRST project.

Question. Going forward, how important will stakeholder input into the uses of IRA funding for the IRS be?

How, where, and when can such input be facilitated?

Answer. The worst possible outcomes from IRA funding will stem from neglect—neglect of stakeholder input, neglect of oversight from entities such as TIGTA and National Taxpayer Advocate, and neglect of Congress (largely due to a crowded legislative agenda). Many of the traditional stakeholder input processes that help to inform the decisions of many other Federal entities—such as the Administrative Procedure Act—have been a source of controversy and litigation for more than a decade with the IRS. Other forums for stakeholder input, among them the Taxpayer Advisory Panels, the IRS Advisory Council, National Taxpayer Advocate, and the Electronic Tax Administration Advisory Committee, can provide useful guidance to the Service, but such guidance is not binding and can span a wide range of administrative issues.

Several additional steps can and should be taken to facilitate actionable input on uses of IRA funding. These include:

- (1) Although the IRA funding has taken place outside the regular appropriations process, there is no reason why that process should not provide appropriations committees with the opportunity to evaluate the effectiveness of various IRA-funded initiatives. The committees should be able to demand cost-benefit analysis and progress reports from the IRS on each element of the Strategic Operating Plan. After all, how IRA funding is being put to work directly impacts decisions for allocation annual appropriations to the IRS, and vice versa.
- (2) I must reiterate here the value of the IRS Oversight Board concept which, for a few years after enactment of the 1998 IRS Restructuring and Reform Act, provided incisive managerial recommendations and reports to Congress on how transformation funding was spent in accordance with the objectives of the statute and the strategic plans developed by IRS leadership. Congress can and should consider legislation improving this concept.
- (3) While there are numerous entities collecting input from stakeholders on various aspects of tax administration (see list above), I believe that insufficient consideration is currently being given to the role that the recently established Taxpayer Experience Office at IRS could play as a central coordinator of that input. The Committee could request that the Commissioner task the TEO with serving as a clearinghouse for IRA funding input from stakeholders and report quarterly to Congress on trends. Alternatively, if independence or transparency is a concern, the National Taxpayer Advocate could be assigned this function.
- (4) The IRS should be encouraged to utilize “real-time” feedback tools when interacting with taxpayers. One such tool is the “regulatory sandbox,” which allows regulators and regulated entities to engage in a structured, productive environment focused on problem solving rather than posturing. A regulatory sandbox model could be adapted to the purpose of engaging in exercises over IRA resource allocation and prioritization. As an example, experts from private sector could be invited to design different hierarchies for various parts of the IT infrastructure, positing the “what ifs” from one approach to modernization versus another. My colleague Ryan Nabil has written extensively about regulatory sandboxes in the United States and abroad and would be delighted to discuss them with the committee further.

Question. What recommendations would you make to Congress in how it should oversee IRS hiring and personnel practices as IRA funding is implemented?

Answer. Most of the recommendations I would make in this area pertain to IRS hiring and personnel practices in general, not only those confined to IRA funding. Perhaps the only difference between “normal” IRS hiring and IRA-related hiring is

a sense of urgency and pressure associated with the need to meet the revenue “score” associated with the IRA resources. This is a grim reminder of the need to avoid the temptation to tie personnel decisions to specific collection goals. During the 1980s and 1990s, NTU was among many organizations that worked with Congress to end the IRS managerial culture that was seen as providing rewards and promotions to personnel based on their ability to obtain the most money from taxpayers in enforcement actions. Congress and the IRS must take every step to ensure that this culture never takes root again. NTU would gladly provide archival documents about the history of this struggle.

On a more practical level, Congress could request that GAO conduct a survey of available literature and studies on the following:

- (1) Private firms involved in financial transactions (*e.g.*, loan repayments and overdue credit card payments) on how their employees are trained to respect consumer rights and comply with the law.
- (2) How the most successful law enforcement and customer service agencies at the State and Federal levels have met their recruiting goals without sacrificing quality.
- (3) How tax agencies abroad have restructured their workforces to not only be more efficient, but also to foster trust with the taxpaying population.

Of particular assistance with (3) would be the Center for Taxpayer Rights, established by former National Taxpayer Advocate Nina Olson. The Center has access to many sources of information on hiring and personnel practices that could benefit the IRS and the taxpayers it is meant to serve. Another suggestion regarding (2) would be to consult with ETAAC member Mark Godfrey, who was part of the Missouri Department of Revenue’s effort to bring a more taxpayer-centric culture to the workforce (including an objective of a 100-percent answer rate for taxpayer calls received by the agency).

PREPARED STATEMENT OF HON. RON WYDEN,
A U.S. SENATOR FROM OREGON

In recent months, this committee has held three hearings, two with Commissioner Werfel and one with Secretary Yellen, in which Republicans have attacked the Inflation Reduction Act funding for the IRS.

The first bill that House Republicans passed in 2023 repealed the bulk of that funding. Repeal is a centerpiece of Speaker McCarthy’s default plan, which would also destroy 780,000 jobs and increase the odds of a recession.

By all outward appearances, repealing this funding is the Republicans’ top economic priority. That’s why the Finance Committee is meeting this morning—to break down, point by point, all the harm repealing it would do, especially as a part of the overall McCarthy plan.

First, I want to focus on the major setback for criminal law enforcement. As a way to frighten typical taxpayers, Republicans have fabricated a whole lot of stories about 87,000 armed agents busting down the doors at local businesses and people’s homes. It’s nonsense.

The truth is, the IRS has a modest but critically important team of law enforcement personnel. They work on busting human trafficking rings, drug cartels, and enablers of child exploitation. They root out individuals and groups financing terrorists. They help crack down on criminal tax fraud and evasion, including the kind of evasion the Finance Committee identified with our 2-year investigation of how Swiss bank Credit Suisse enabled a group of dual U.S. and foreign citizens to cheat on paying U.S. taxes.

At this moment, the IRS Criminal Investigation division is working with partners in Ukraine to hunt down crooks who are evading sanctions on Russia.

And recently, the Criminal Investigation division collaborated with the FBI, the Department of Justice, and law enforcement partners around the world on the largest fentanyl distribution takedown in history. It resulted in hundreds of arrests and the seizure of \$54 million and 850 kilograms of drugs, including the equivalent of millions of lethal doses of fentanyl.

Republican cuts reduced the workforce of Criminal Investigation special agents by 26 percent. Democrats passed IRA funding to help rebuild it, but Republicans now want to repeal that funding. Others say the funding ought to be targeted elsewhere.

The question is, if you want to cut this enforcement spending, which criminal activity do you propose letting slide? Drug rings? Money laundering? Sex trafficking and child abuse?

Yesterday, the committee received a letter from the Federal Law Enforcement Officers Association opposing the Republican plan. This is a group representing tens of thousands of Federal law enforcement officers from across dozens of agencies. Without objection, I'll enter that letter into the hearing record.

Second issue: coming off the smoothest tax filing season in many years, the McCarthy repeal plan would once again clobber taxpayer service and force Americans to spend hours waiting on hold with the IRS.

House Republicans are hiding the ball on this issue. The McCarthy plan would leave the temporary IRA funding for taxpayer service in place, and Republicans will insist that's proof they're interested in maintaining better service.

Here's what they're not telling the American people: the McCarthy plan would also hit the IRS with across-the-board budget cuts just like the ones that steadily wrecked taxpayer service before Democrats were able to start fixing it last year. Nobody is asking for a return to 10- or 15-percent call response rates at the IRS.

Third, the McCarthy plan to repeal the IRS funding would lead to a \$120-billion increase in the deficit. How would his plan offset that deficit increase? By kicking people off their health insurance, increasing child hunger, worsening education, and weakening border security, among many other examples.

With all that said, if you're looking for the big winners of the McCarthy IRS defunding plan, it's billionaires and corporations who cheat on their taxes. The Inflation Reduction Act funding for the IRS was designed to make sure they pay what they owe. Repealing that funding is a \$191-billion giveaway to wealthy tax cheats.

The effect of Republican IRS cuts has been clear. From 2010 to 2017, when Republicans cut the IRS most aggressively, audit rates for millionaires went down 77 percent; for large corporations, down 44 percent; for complex partnerships, down 80 percent. Performing those audits takes a lot of hard work by highly skilled staff, and the IRS has lost 40 percent of those agents.

Republican cuts shifted the burden of tax enforcement onto working people. Auditing them was easy. An audit of a simple individual taxpayer's return takes 5 hours on average. Auditing a higher-income tax cheat takes an average of 250 hours. Corporate audits and audits of large, complex partnerships can take even longer, sometimes several years. And they require large teams with a lot of expertise. Republican budget cuts systematically dismantled much of that expertise in the previous decade, and the McCarthy plan would decimate it going forward.

The bottom line is, the McCarthy plan would lead to more tax evasion by the rich, worse taxpayer service for law-abiding Americans, and fewer prosecutions of drug cartel members, sex criminals, sanctions evaders, and money launderers. Obviously, this cannot pass.

So there's a lot for us to discuss today. I'm looking forward to hearing from our witnesses.

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May 15, 2023

Chairman Ron Wyden
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Ranking Member Mike Crapo
Committee on Finance
Washington, DC 20510

RE: Funding Federal Law Enforcement

Dear Chairman Wyden and Ranking Member Crapo:

The Federal Law Enforcement Officers Association (FLEOA)—the nation’s largest non-partisan professional association, representing more than 32,000 active and retired federal law enforcement officers from over 65 federal agencies—applauds your efforts to prioritize and support funding for the Criminal Investigation Division (CI) of the IRS. FLEOA opposes any efforts or legislation that cuts funding for law enforcement, including H.R. 2811—Limit, Save, Grow Act of 2023.

As the 6th largest federal law enforcement agency, CI serves a crucial role in supporting national law enforcement priorities and high-impact financial investigations. From protecting Americans against stolen identity refund fraud (SIRF) and cyber-crime to dismantling large scale transnational organized crime syndicates, major drug cartels, international money laundering schemes, and having sole authority to investigate federal tax crimes, CI is an important national law enforcement asset.

CI plays a key role in the Department of Justice’s efforts to investigate and prosecute complex financial crimes and criminal activity where money is a motivating factor. This includes priority multi-agency task forces focused on thwarting the trafficking of fentanyl, narcotics and the fight against global terrorism. Just a few weeks ago, CI was the lead investigative agency in the largest international fentanyl/opioid seizure in U.S. history. This CI led operation took down a massive drug trafficking operation that led to the arrest of 288 dangerous criminals and seized an astounding 64kg of fentanyl and fentanyl-laced opioids. CI also assists in the identification and seizure of sanctioned Russian oligarch assets. CI’s efforts play a pivotal role in protecting Americans from dangerous criminal networks.

CI is so prolific at conducting these high-impact financial investigations that they are regularly the largest contributor to the Treasury Forfeiture Fund, which is comprised of non-tax criminally derived assets seized by Treasury and Homeland Security law enforcement agencies. In addition to depriving criminal organizations of their illicit proceeds, where possible, funds are returned to victims of financial crimes.

Since 2010, CI’s staffing has experienced an alarming decline. In 2010 CI had approximately 4,000 employees of which about 2,760 were special agents. At the close of 2022, CI had only 3,000 employees of which about 2,075 were special agents. Historically, CI has been second only to the FBI in bringing white-collar criminal prosecutions. Unsurprisingly, CI’s crushing drop in staffing directly correlates to a steady decline in white-collar crime prosecutions by DOJ over the same 12-year period. Any reduction in CI funding will undermine critical efforts to attack the distribution of fentanyl and other deadly narcotics that are disproportionately impacting America’s youth.

We urge you to continue prioritizing the financial investigative mission of CI and applaud your recent efforts to hold hearings and initiate discussions on the crucial importance of proper CI funding. Our membership, which includes CI Special Agents in Charge and Senior Executives, welcome the opportunity to work with you on this and other important issues related to CI and their ability to protect and serve America.

Sincerely,

Larry Cosme
National President
Federal Law Enforcement Officers Association

COMMUNICATION

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Statement of Michael Bindner

Chairman Wyden and Ranking Crapo, thank you for the opportunity to address this issue.

It seems like we were just talking about this as recently as April 19. In our comments, we will address what the increased IRS funding really pays for and why it is important and how the Majority could adopt the Fair Tax proposal into several consumption taxes (rather than a single tax) and actually defund the IRS.

Anyone who has ever made a mistake on their taxes (like omitting a child's Social Security number) or has been in arrears and needed a payment plan knows what it can be like to reach an actual IRS agent. While the agency could certainly leverage its resources by contracting out customer service telecommunications, there are some items, like payment negotiations, that must be handled with agency personnel.

It is reported that during the pandemic and its recovery period, when people had questions on how to start their enhanced Child Tax Credit payments—or had actual difficulty filing for them—that it was impossible to get an agent on the phone. Both the pandemic and underfunding were equally responsible. The additional money for IRS fixed this.

Given the number of poor people in the states sending Republicans to Congress, it makes no sense to claw this money back. Even donors want to get the IRS on the phone, so playing politics with customer service makes no sense. Lincoln had something to say about fooling some of the people some of the time. Some of these people may even be less informed members of the Senate minority or their staffs.

The repeal of *Roe v. Wade* makes returning to the Pandemic-era Child Tax Credit essential. Increased funding is included in the President's Budget and will eventually pass (once Special Counsel Smith has examined what was known by the House Freedom Caucus and when they knew it). The question is, how do we want these funds to be distributed. Should the IRS be a direct social services provider? As we have stated before. . . .

. . . to end the “stink of welfare” that Senator Manchin so objects to, CTC payments should be included with wages for all employees—not just those with three or more children. They should also be distributed through other federal and state assistance programs—some of which can be reduced to do so.

For middle-income taxpayers whose increased credits are less than their annual tax obligation, a simple change in withholding tables is adequate. Procedures are already in place to deliver refundable credits to larger families. For the coming year, they merely need to be expanded to all families with children.

Employers can work with their bankers to increase funds for payroll throughout the year while requiring less money for their quarterly tax payments (or estimated taxes) to the IRS. The main issue is working out those situations where employers owe less than they pay out. This is especially true for labor intensive industries and even more so for low wage employers.

A higher minimum wage would make negative quarterly tax bills less likely. Indeed, no one should have to subsist mainly on their child tax payments.

As usual, we have attached the latest version of our tax reform plan, with a separate attachment on how implementation of this plan would affect IRS manpower. The answer is that the change would be drastic. It would also allow the Committee to focus more on how social welfare is being delivered in general, as well as eliminating current roadblocks to promptly filing for Social Security Disability Income.

Let me relate the various provisions to the Fair Tax (and how to modify it).

The closest tax to the Fair Tax we propose is the Invoice Value-Added Tax. It would fund discretionary government (and, if a constitutional amendment allowed uneven excise taxes), this could be done on a regional basis. Those regions who want to have a lower rate would fund less government. Those who want more projects and military bases would pass a higher tax.

This tax would also replace the employer contribution to Social Security, but to make revenue accumulation look more like payment distribution, this revenue would be credited equally to all workers who accumulate the minimum number of credits in a quarter. The employee contribution would remain as it is. The check goes to the Department of the Treasury in either instance and the Social Security Administration will record the proceeds in exactly the same way.

A main objection to the Fair Tax is that it can be gamed by claiming everything you buy is wholesale. This is a big hole, a hole that value-added taxes fix. There is already a value-added tax on the books, although it is intergovernmental and inadequate. Businesses who collect sales taxes can already deduct them from their business income. This puts the national government in the position of subsidizing state and local sales taxes. The Fair Tax could include this provision for a federal sales tax as well.

The inadequacy comes from the fact that taxes paid are a deduction rather than a credit. This can, indeed this must be fixed—whether the Fair Tax is enacted or not. Any federal tax paid must be fully credited at the federal level, with state taxes paid credited at the state level. These tax payments should still be used to adjust income. For example, state business income would be reduced by federal Fair Tax or VAT while federal income continues to be adjusted in the current manner.

The other issue with the Fair Tax is that payments to families would be shifted from tax credits to payments from the Treasury (regardless of whether Social Security or the IRS distributes them). Payments above the “prebate” level would be shifted to state social welfare agencies through either new income stabilization programs or by putting most American families on the Food Stamp rolls.

The amount of these subsidies is uneven. Minor children of disabled or retired parents get various benefit levels and the Earned Income Tax Credit and Child Tax Credit phase in and out at various income levels. A universal child credit added to wages or income support programs (including OASDI, Unemployment Insurance and Pell Grants) would unravel this mess and allow all but the richest families to avoid filing taxes at all (unless they were filing separately as a business owner). For workers, these payments would be distributed with wages as an offset to a second consumption tax—what we call a subtraction VAT, which is essentially a net business receipts tax.

Health-care subsidies would also be added to this tax. Firms who provide insurance coverage would be able to credit a portion of their premiums as a credit against this tax. The proceeds would fund any subsidized public option, which would replace Medicaid for the working poor. Medicaid for nursing homes would be funded by the Invoice VAT.

States would also use a subtraction VAT as a vehicle for additional income subsidies for high-cost states (or urban areas), as well as using the tax to fund other social services (again, with offsets) if employers provide these services—such as tuition assistance for workers and their families—as well as any other social welfare spending (for example, mental health care and housing) that should be funded by employers rather than through property or sales taxes.

If the Child Tax Credit is adequate to meet the needs of most families, rebates for Fair Taxes and Carbon taxes would not be necessary. Instead of limiting Child Tax Credit payments to families based on higher (or lower) incomes, a subtraction VAT surtax would be levied on cash payments to workers or investors in excess of the

Social Security Employee Payroll tax cap, with graduated rates for higher incomes. The firm would pay these amounts, not the individual employees, with individual taxation paid on cash salary, dividend or interest income above approximately \$400,000 per year—again, with graduated rates of between 6.5% to 26% (more or less).

Subtraction VAT would entirely replace Corporate Income Taxation at all levels. The surtax for cash payments to higher income investors or workers would replace most collections of personal income tax and would assure parity between the tax treatments of labor and capital. There would also be no industry based tax subsidies, save for the deduction of all material costs (possibly including equipment, unless the decision is made to maintain depreciation rules).

Capital gains and estate (or death) taxes would be repealed. Stocks could be considered a consumer good, with a Fair Tax payment for each transaction, or could be levied as an asset value-added tax. For those who don't know economics, and for some who do, investment in secondary markets does not add to Gross Domestic Product. It is savings—or rather—it is gambling. In corporate bankruptcy, stock is worthless.

Like the rest of the tax system, the capital gains and estate taxes are a maze of rates depending on income and time the asset is held. A single rate would be instituted instead for all short and long term investments. Cash payments in inheritance would not be taxed until they are spent or reinvested. This allows for closing all the loopholes in the system, from life insurance to avoid taxation to borrowing from stock to using business losses to reduce taxes on wages and salaries.

Thank you, again, for the opportunity to add our comments to the debate. Please contact us if we can be of any assistance or contribute direct testimony.

Attachment One—Tax Reform, Center for Fiscal Equity, March 24, 2023

Synergy: The President's Budget for 2024 proposes a 25% minimum tax on high incomes. Because most high income households make their money on capital gains, rather than salaries, an asset value-added tax replacing capital gains taxes (both long- and short-term) would be set to that rate. The top rate for a subtraction VAT surtax on high incomes (wages, dividends and interest paid) would be set to 25%, as would the top rate for income surtaxes paid by very high-income earners. Surtaxes collected by businesses would begin for any individual payee receiving \$75,000 from any source at a 6.25% rate and top out at 25% at all such income over \$375,000. At \$450,000, individuals would pay an additional 6.25% on the next \$75,000 with brackets increasing until a top rate of 25% on income over \$750,000. This structure assures that no one games the system by changing how income is earned to lower their tax burden.

Individual payroll taxes. A floor of \$20,000 would be instituted for paying these taxes, with a ceiling of \$75,000. This lower ceiling reduces the amount of benefits received in retirement for higher-income individuals. The logic of the \$20,000 floor reflects full time work at a \$10 per hour minimum wage offered by the Republican caucus in response to proposals for a \$15 wage. The majority needs to take the deal. Doing so in relation to a floor on contributions makes adopting the minimum wage germane in the Senate for purposes of Reconciliation. The rate would be set at 6.25%.

Employer payroll taxes. Unless taxes are diverted to a personal retirement account holding voting and preferred stock in the employer, the employer levy would be replaced by a goods and receipts tax of 6.25%. Every worker who meets a minimum hour threshold would be credited for having paid into the system, regardless of wage level. All employees would be credited on an equal dollar basis, rather than as a match to their individual payroll tax. The tax rate would be adjusted to assure adequacy of benefits for all program beneficiaries.

High-income Surtaxes. As above, taxes would be collected on all individual income taxes from salaries, income and dividends, which exclude business taxes filed separately, starting at \$400,00 per year. This tax will fund net interest on the debt (which will no longer be rolled over into new borrowing), redemption of the Social Security Trust Fund, strategic, sea and non-continental U.S. military deployments, veterans' health benefits as the result of battlefield injuries, including mental health and addiction and eventual debt reduction.

Asset Value-Added Tax (A-VAT). A replacement for capital gains taxes and the estate tax. It will apply to asset sales, exercised options, inherited and gifted assets

and the profits from short sales. Tax payments for option exercises, IPOs, inherited, gifted and donated assets will be marked to market, with prior tax payments for that asset eliminated so that the seller gets no benefit from them. In this perspective, it is the owner's increase in value that is taxed. As with any sale of liquid or real assets, sales to a qualified broad-based Employee Stock Ownership Plan will be tax-free. These taxes will fund the same spending items as high-income and subtraction VAT surtaxes. There will be no requirement to hold assets for a year to use this rate. This also implies that this tax will be levied on all eligible transactions.

The 3.8% ACA-SM tax will be repealed as a separate tax, with health-care funding coming through a subtraction value-added tax levied on all employment and other gross profit. The 25% rate is meant to be a permanent compromise, as above. Any changes to this rate would be used to adjust subtraction VAT surtax and high-income surtax rates accordingly. This rate would be negotiated on a world-wide basis to prevent venue seeking for stock trading.

Subtraction Value-Added Tax (S-VAT). Corporate income taxes and collection of business and farm income taxes will be replaced by this tax, which is an employer paid Net Business Receipts Tax. S-VAT is a vehicle for tax benefits, including

- Health insurance or direct care, including veterans' health care for non-battlefield injuries and long-term care.
- Employer paid educational costs in lieu of taxes are provided as either employee-directed contributions to the public or private unionized school of their choice or direct tuition payments for employee children or for workers (including ESL and remedial skills). Wages will be paid to students to meet opportunity costs.
- Most importantly, a refundable Child Tax Credit at median income levels (with inflation adjustments) distributed with pay.

Subsistence-level benefits force the poor into servile labor. Wages and benefits must be high enough to provide justice and human dignity. This allows the ending of state administered subsidy programs and discourages abortions, and as such enactment must be scored as a must pass in voting rankings by pro-life organizations (and feminist organizations as well). To assure child subsidies are distributed, S-VAT will not be border-adjustable.

As above, S-VAT surtaxes are collected on all income distributed over \$75,000, with a beginning rate of 6.25%. replace income tax levies collected on the first surtaxes in the same range. Some will use corporations to avoid these taxes, but that corporation would then pay all invoice and subtraction VAT payments (which would distribute tax benefits). Distributions from such corporations will be considered salary, not dividends.

Invoice Value-Added Tax (I-VAT). Border-adjustable taxes will appear on purchase invoices. The rate varies according to what is being financed. If Medicare for All does not contain offsets for employers who fund their own medical personnel or for personal retirement accounts, both of which would otherwise be funded by an S-VAT, then they would be funded by the I-VAT to take advantage of border adjustability.

I-VAT forces everyone, from the working poor to the beneficiaries of inherited wealth, to pay taxes and share in the cost of government. As part of enactment, gross wages will be reduced to take into account the shift to S-VAT and I-VAT, however net income will be increased by the same percentage as the I-VAT. Inherited assets will be taxed under A-VAT when sold. Any inherited cash, or funds borrowed against the value of shares, will face the I-VAT when sold or the A-VAT if invested.

I-VAT will fund domestic discretionary spending, equal dollar employer OASI contributions, and non-nuclear, non-deployed military spending, possibly on a regional basis. Regional I-VAT would both require a constitutional amendment to change the requirement that all excises be national and to discourage unnecessary spending, especially when allocated for electoral reasons rather than program needs. The latter could also be funded by the asset VAT (decreasing the rate by from 19.25% to 13%).

Carbon Added Tax (C-AT). A Carbon tax with receipt visibility, which allows comparison shopping based on carbon content, even if it means a more expensive item with lower carbon is purchased. C-AT would also replace fuel taxes. It will fund transportation costs, including mass transit, and research into alternative fuels. This tax would not be border adjustable unless it is in other nations, however

in this case the imposition of this tax at the border will be noted, with the U.S. tax applied to the overseas base.

Attachment Two—Tax Administration, Treasury Budget, February 12, 2020

Shifting to a single system for all business taxation, particularly enacting invoice value-added taxes to collect revenue and employer-based subtraction value-added taxes to distribute benefits to workers will end the need for filing for most, if not all, households. Any remaining high-salary surtax would be free of any deductions and credits and could as easily be collected by enacting higher tiers to a subtraction VAT.

Subtraction VAT collection will closely duplicate the collection of payroll and income taxes—as well as employment taxes—but without households having to file an annual reconciliation except to verify the number of dependents receiving benefits.

Tax reform will simplify tax administration on all levels. Firms will submit electronic receipts for I-VAT and Carbon Added Tax (C-AT) credit, leaving a compliance trail. S-VAT payments to providers, wages and child credits to verify that what is paid and what is claimed match and that children are not double credited from separate employers.

A-VAT transactions are recorded by brokers, employers for option exercise and closing agents for real property. With ADP, reporting burdens are equal to those in any VAT system for I-VAT and A-VAT and current payroll and income tax reporting by employers.

Employees with children will annually verify information provided by employers and IRS, responding by a postcard if reports do not match, triggering collection actions. The cliché will thus be made real.

High-salary employees who use corporations to reduce salary surtax and pay I-VAT and S-VAT for personal staff. Distributions from such corporations to owners are considered salary, not dividends.

Transaction based A-VAT payments end the complexity and tax avoidance experienced with income tax collection. Tax units with income under \$84,000 or only one employer need not file high salary surtax returns. Separate gift and inheritance tax returns will no longer be required.

State governments will collect federal and state I-VAT, C-AT, S-VAT payments, audit collection systems, real property A-VAT and conduct enforcement actions. IRS collects individual payroll and salary surtax payments, performs electronic data matching and receive payments and ADP data from states. SEC collects A-VAT receipts.

I-VAT gives all citizens the responsibility to fund the government. C-AT invoices encourage lower carbon consumption, mass transit, research and infrastructure development. A-VAT taxation will slow market volatility and encourage employee ownership, while preserving family businesses and farms. Very little IRS Administration will be required once reform is fully implemented. All IRS employees could fit in a bathtub with room for Grover Norquist.

