

# Opening Statement

## Senate Appropriation Subcommittee on Financial Services and General Government, May 19, 2021

### Internal Revenue Service: Narrowing the Tax Gap and Improving Taxpayer Services

#### Testimony of Charles O. Rossotti, IRS Commissioner, 1997-2002

Mr. Chairman and Ranking Member,

Thanks for allowing me to testify on how to shrink the ever-growing tax gap.

We estimate that the amount of taxes that were legally owed but not paid was \$574 billion in 2019 and will accumulate to \$7.5 trillion over ten years. This amount in 2019 was equal to what the lower 90% of individuals, 135 million taxpayers, paid in federal income taxes. Commissioner Rettig recently testified the tax gap may be even larger than that.

We estimate that it is practical to recover \$1.4 trillion of this tax gap over ten years, which is still only 19% of the total. All this gain would be from the top 25% of taxpayers and the majority from the top 3%.

Tax compliance is heavily driven by whether a taxpayer's income is reported by third parties in a manner that the information can be efficiently used by the IRS. Where income is reported and easily checked from forms such as W-2's and 1099's, compliance is 95 to 99%. Almost all the tax on that income is paid voluntarily without IRS intervention. Where income is not reported, compliance is as low as 50%.

Our plan for shrinking this tax gap is based on an integrated three-part program:

First, move more income from low visibility to higher visibility by filling the gaps on income that is not reported by third parties to the IRS.

Second, upgrade IRS technology to make full use of all the information available to the IRS to increase the effectiveness and efficiency of all IRS compliance activities.

Third, rebuild IRS's skilled workforce and provide them technology to resolve taxpayer cases more rapidly and efficiently.

It is critical to use technology to make the entire compliance process far more efficient because simply scaling up what the IRS does today will not produce the desired results. Currently, all of IRS auditing activity recovers only about 2.5% of the tax gap.

For example, the IRS today cannot efficiently evaluate information on 40 million K-1 forms, on the 1099-k reports from payers, or on submissions required by FATCA. Modern technology can effectively use this information to identify potential deficiencies.

Technology will also allow the IRS to transform the follow-up process when deficiencies are identified to one that is far more accurate and efficient for taxpayers and the IRS than traditional auditing.

The technology we propose is not futuristic. It is widely used today including on a limited scale in the IRS, for example in screening refunds

Most of the gain in our plan comes from increased voluntary compliance so it is essential to make compliance as easy as possible. The investments we propose would increase the ease and speed of dealing with the IRS and reduce the number of unnecessary audits.

We also recommend that this committee follow its bipartisan practice of establishing pertinent taxpayer rights when it considers legislating authority for the IRS and our plan proposes several new or clarified taxpayer rights.

Our program requires both authorization and consistent long-term funding from Congress. We recommend a funding increase of about 6% per year above what is required to sustain IRS operations. Spreading this increase over 10 years is what will allow the IRS to make effective use of the funds Congress is providing.

Over a decade this investment will produce a revenue gain of about 20 times its cost and will vastly increase the quality of service the IRS provides to taxpayers.

Implementing this program will be challenging, but based on my 50 years of managing programs in business and government I believe it is achievable and clearly outbalances any risks. As Congress did when it passed the IRS Restructuring and Reform Act, compliance and service goals can be established, progress could be measured year-by-year and closely monitored by Congressional oversight committees.

I note that our proposals are for long term investment. In the short term, the IRS must focus on the immediate priorities of the filing season, the economic recovery program and the new child tax credit.

Finally, I believe that fundamental fairness alone is a compelling reason to address this problem, particularly when Congress is contemplating raising taxes on people who already pay what they owe.