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Biden Proposal to Increase Tax Compliance

The U.S. Department of Treasury (Treasury) has issued a press release on May 20, 2021 as well as a report entitled, "The American Families Plan Tax Compliance Agenda." The report contains more information on the Biden administration proposal to increase tax compliance, including proposals to increase information reporting by banks and with respect to cryptocurrencies.

Treasury has now provided additional details regarding the tax gap and its proposals to increase tax compliance.

Warning!

This is just a proposal by President Biden. As such it is short on details. This is not law and some or all of it will not become law. The following is for information purposes only and should not be acted upon until final law is passed.

We would expect final legislation, if any, to occur in the fourth quarter of this year. The political landscape is unique in 2021, with the expiration of the emergency debt ceiling suspension expiring at the end of July, 2021 and the razor thin Democratic control in the Senate which will in effect give every Senator effective veto power as they try to pass legislation through the budget reconciliation process.

We will keep you apprised as legislation continues to move through Congress.

The Tax Gap

According to Treasury analysis, the tax gap totaled nearly $600 billion in 2019 and will rise to about $7 trillion over the course of the next decade if left unaddressed -roughly equal to 15% of taxes owed.

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

The tax gap has three distinct elements: taxpayers who fail to file returns in a timely manner (the "non-filing" tax gap, around 9% of the gross tax gap); those who underreport income or overclaim deductions and credits on tax returns (the "underreporting" tax gap); and those who underpay taxes despite reporting obligations in a timely manner (the "underpayment" tax gap, around 11%). By far the largest contributor to the tax gap is the underreporting gap—around 80%.

Proposals to increase compliance.

The compliance proposals fit into the following four categories:

- Increasing the resources of the IRS to pursue noncompliant taxpayers and better serve those who are fully compliant.
- Increasing information reporting, including leveraging information that financial institutions already collect to shed light on those taxpayers who misreport income derived from less common categories.
- Overhauling antiquated technology to help IRS leverage data analytic tools; and
- Regulating paid tax preparers and increasing penalties for those who those who intentionally commit malfeasance.

Increasing IRS resources

As previously announced by Treasury, the administration proposes providing IRS with nearly $80 billion in additional resources over the next decade. The IRS would grow no more than around 10% annually but would also have certain funding in place to make investments with large fixed costs—like modernizing information technology, improving

data analytic approaches, and hiring and training agents dedicated to complex enforcement activities. This would make up the ground that the IRS has lost over the last decade. During this time, the IRS budget fell by about 20%, leading to a sustained decline in its workforce particularly among specialized auditors who conduct examinations of high-income and global high net worth individuals and complex structures, like partnerships, multi-tier pass-through entities, and multinational corporations.

Increasing information reporting

The new reporting regime would build from the framework of the Form 1099-INT reports that taxpayers already receive from financial institutions. Financial institutions would report additional data on the financial accounts of these existing information returns. Specifically, the annual return would report gross inflows and outflows on all business and personal accounts from financial institutions, including bank, loan, and investment accounts but carve out exceptions for accounts below a low de minimis gross flow threshold.

Other accounts that are similarly situated to financial institution accounts would also be covered under this new reporting regime— for example, payment settlement entities would also be required to report gross receipts and gross purchases.

The reporting regime would also cover foreign financial institutions and crypto asset exchanges and custodians. Crypto currencies and crypto asset exchange accounts and payment service accounts that accept crypto currencies would be covered.

Further, as with cash transactions, businesses that receive crypto assets with a fair market value of more than $10,000 would also be reported on.

Overhauling outdated technology

The IRS still relies on Individual and Business File Systems that date back to the 1960s— the oldest in the federal government. The result is tax administration built upon a system

that is written in a programming language that is no longer taught, and where new functions are added in a patchwork rather than integrated manner.

Modernization funding would allow the IRS to develop innovative machine learning that can be deployed to better identify suspect tax filings, for example, by comparing returns to similarly situated taxpayers and historical filings in a way that the current IRS ecosystem does not allow. These resources would also support efforts to meet threats to the security of the tax system, like the 1.4 billion cyberattacks the IRS experiences annually.

Regulating paid tax preparers and increasing penalties

Unregulated preparers submit more tax returns than all other preparers combined, and they often make costly mistakes that subject their customers to audits.

In addition to the regulation of paid preparers and service improvements that would simplify tax filing, the President's proposal includes additional sanctions for so-called "ghost preparers" who fail to identify themselves on the tax returns which they prepare.

Projection of increased revenues.

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