Testimony
of
Charles O. Rossotti,
Former IRS Commissioner (1997-2002)
before the
Senate Committee on Finance
Subcommittee on Taxation and IRS Oversight
May 11, 2021

(Information submitted for the record)

Table of Contents

Opening Statement

Senate Finance Subcommittee on Taxation and IRS Oversight, May 11, 2021

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 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.

Summary of Shrink the Tax Gap Plan

One Minute Explanation of How to Recover $1.4 Trillion over 10 Years from Taxes Already in the Tax Code

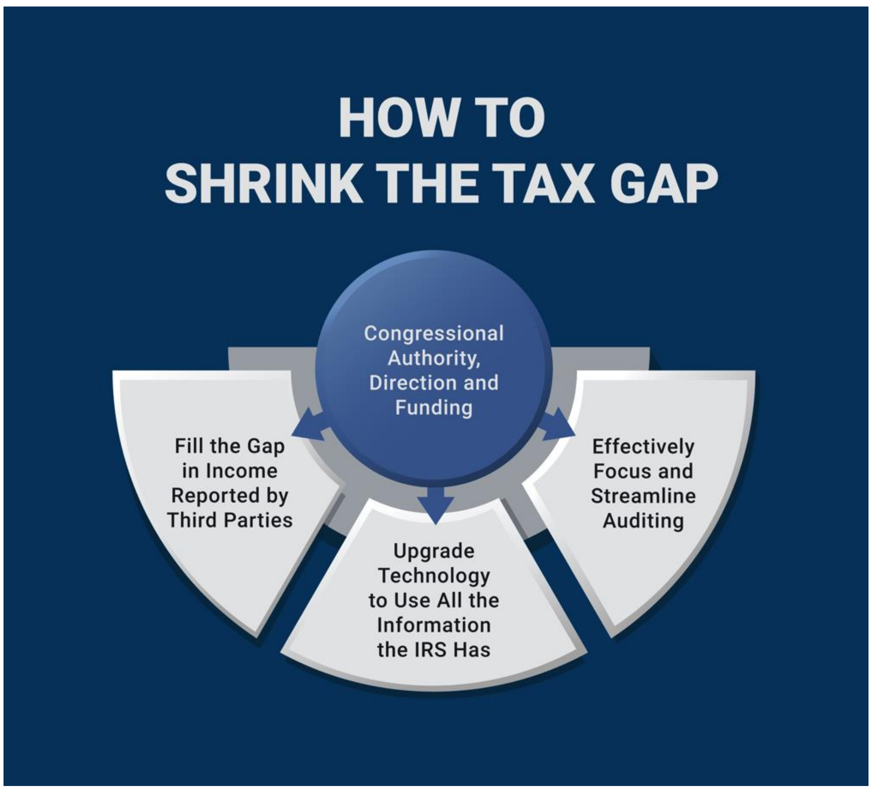
The Tax Gap is all the taxes that are owed but not paid: $574 billion in 2019, and t has been growing every year.

Our shrink the tax gap plan has three elements:

1. *Fill the gap in Information reporting.* Most taxpayers have no choice about paying their tax, because their income is reported by third parties on familiar documents like W-2's and 1099's, so their compliance is 95%. But where there is no reporting, as in much business income, compliance is as low as 50%.
   Our plan moves more income into higher visibility categories through the addition of one 1099 information report on business income of the top income quartile of taxpayers and their businesses.

2. *Upgrade technology* to identify underreported income, to make the follow up process more efficient, and to improve service to all taxpayers.

3. *Effectively focus and streamline auditing.* We would transform auditing to be an essential but a supporting element to complete the follow up process and to deal with complex cases.



We estimate that this plan would shrink the Tax Gap by 19% over 10 years, gaining about $1.4 trillion, almost as much as President Biden’s proposal to increase individual income taxes. All this revenue gain would be from taxpayers in the top quartile of income and most of it would come from increased voluntary compliance. The revenue gain would be about 20 times the cost.

Since most revenue comes from voluntary compliance, making it easier for taxpayers to comply is essential. Our plan would increase IRS increase service to levels to commercial levels. Treating taxpayers fairly, even when there is a dispute, is also essential and our plan proposes expanding taxpayer right.

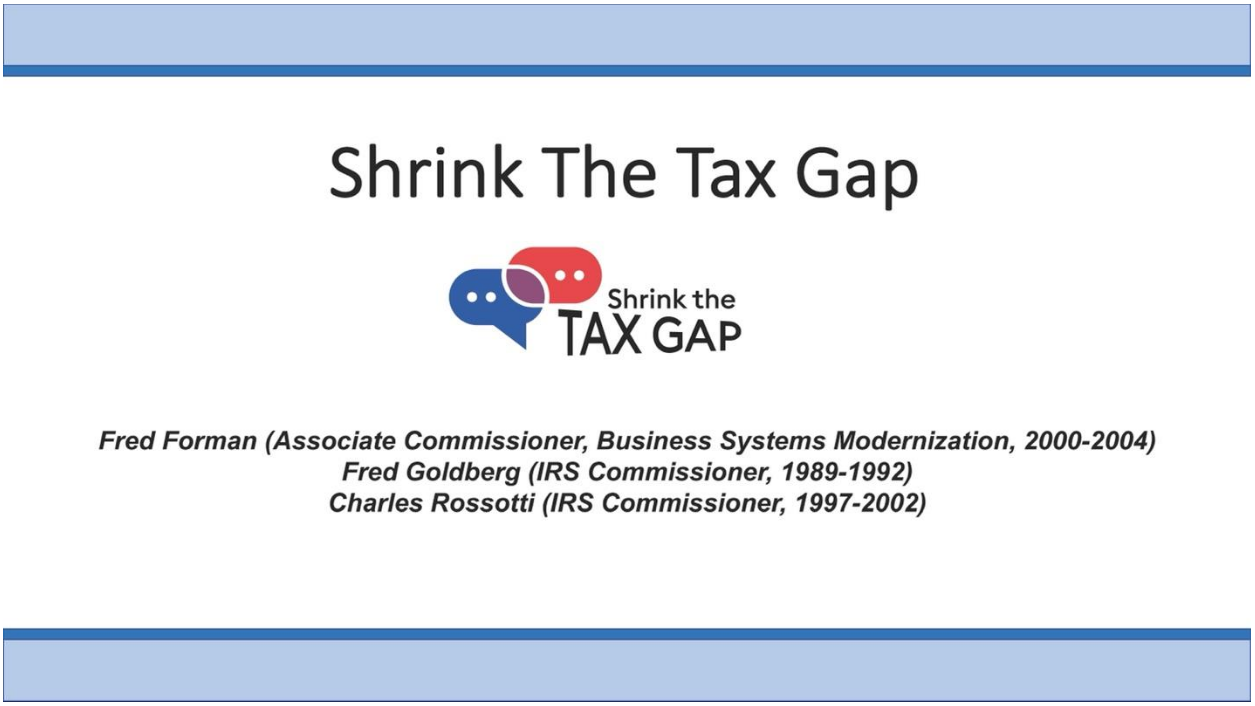
Our plan is a major long-term program that would require Congressional action to provide direction, authority and a source of assured funding of about 6% per year increase over what is needed to sustain IRS operations

All the details are available at [shrinkthetaxgap.com.](shrinkthetaxgap.com)

Shrink the Tax Gap Presentation

This document presents the current version of our STTG plan as of May 3, 2021. We regularly update our plan to reflect comments and further research

Shrink the Tax Gap Authors



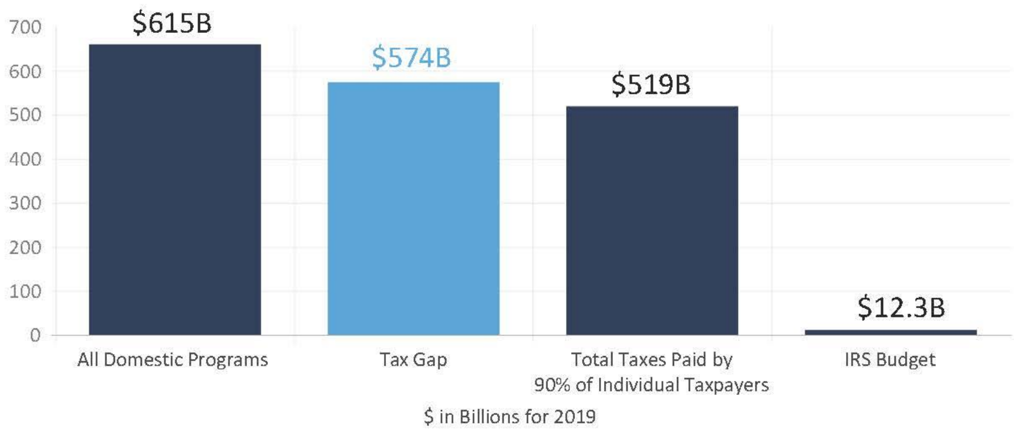
Fred Forman, Fred Goldberg and Charles Rossotti are the authors of the STTG plan. We are private citizens who previously served in leadership positions in the IRS. Most of our work before and after our government service has been in private business.

We began drafting proposals on how to shrink the tax gap because, regardless of what else we as a country do about taxes and the deficit, we believe we should at least do what we reasonably can to collect taxes that are due under the tax code but are not being paid. That unpaid tax is called the tax gap, and it is a longstanding subject of conversation in the tax world, but at this time we believe there is much more that we can do.

Size of the Tax Gap

Here is a chart just to remind us how big this tax gap is on a comparative basis.

How Big is the Tax Gap



Shrink the Tax Gap
2

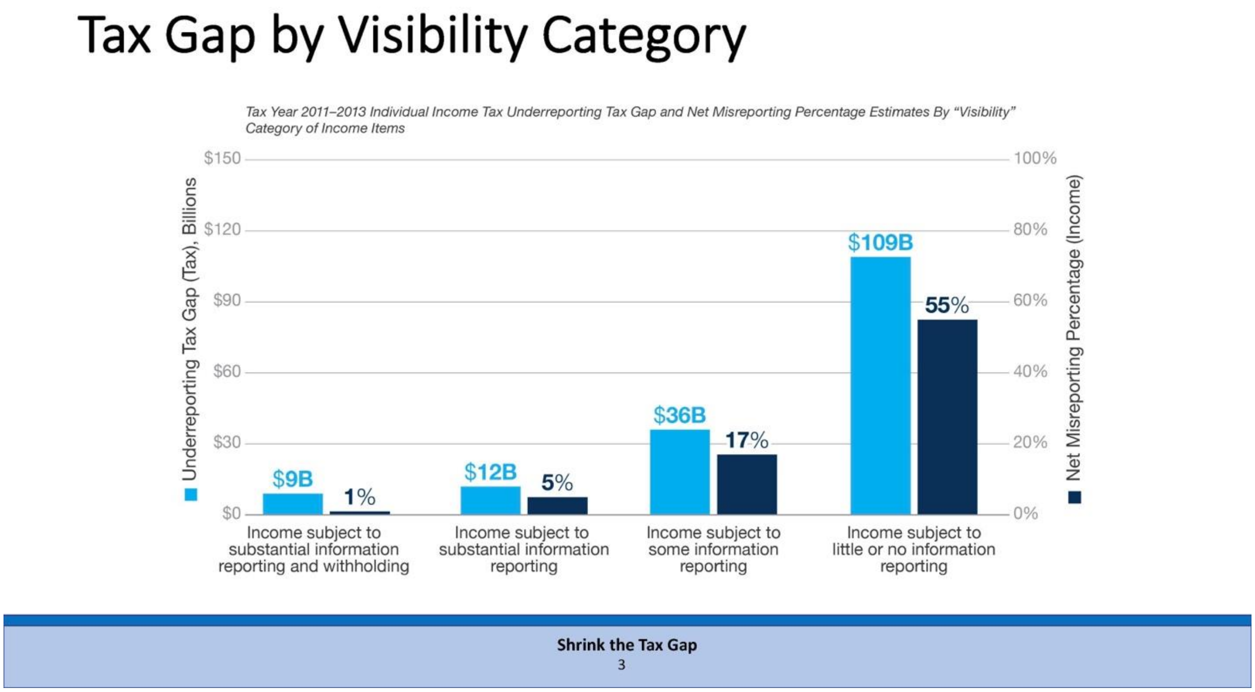
It is more than all the income taxes paid by about 90%, meaning about 135 million, individual taxpayers.

It is 87% of what the government spent on all domestic programs (before Covid).

The tax gap is not only very large, but also growing every year so it will accumulate to about $7.5 trillion over ten years if nothing more is done to address it.

Driver of the Tax Gap—Visibility of Income

The tax gap is largely driven by opportunity to underpay. Where there is little opportunity, because income is fully reported by third parties, such as on w-2’s or 1099’s, and can be efficiently checked by the IRS, there is little underpayment. Where income is less visible and harder to check, there is more opportunity and more underpayment.



This chart from the last IRS compliance study makes that point clearly.

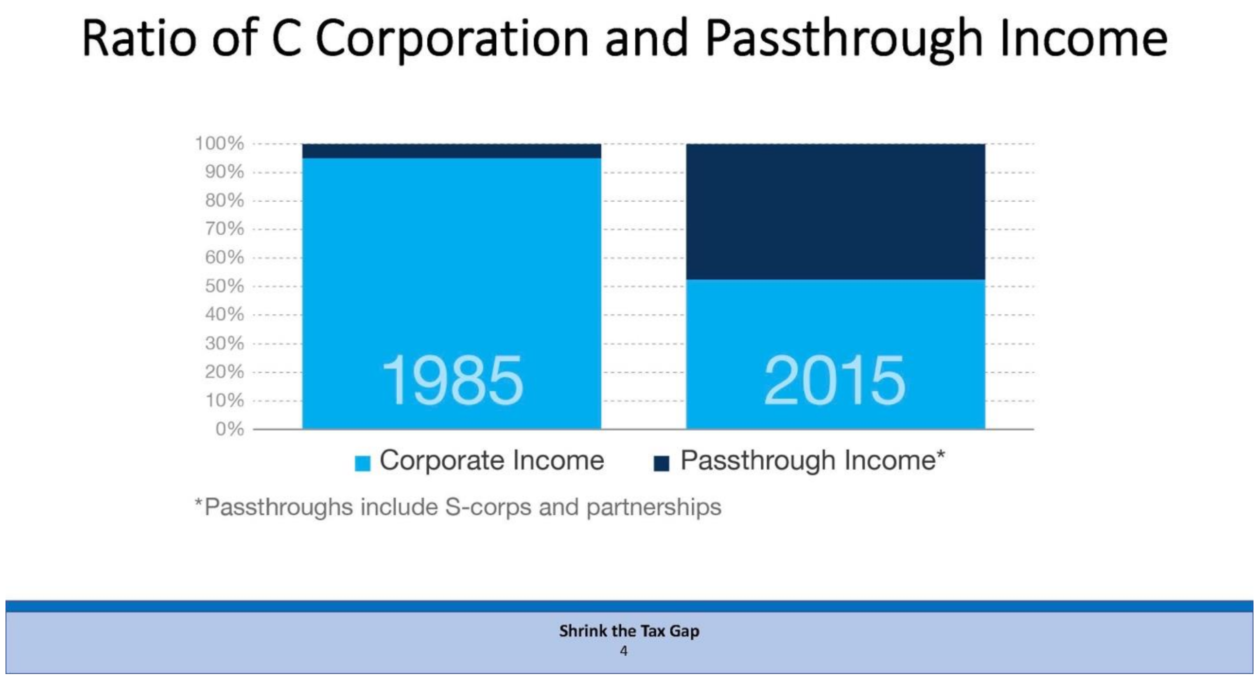
The sources of income that are highly visible and easily checked are on the left of the chart. At least 95% of these sources of income are reported on tax returns. Where income is less visible because there is little or no third-party reporting, as on the right of the chart, only about half is reported.

At least 85% of that low visibility income is earned by the top 25% of taxpayers, so that quartile of taxpayers also accounts for most of the underpayment.

This top quartile of taxpayers also accounts for most of the income, over 95%, reported by businesses organized as passthrough entities, S-corporations and partnerships. These businesses do not pay tax directly but pass the income onto their owners. This category of businesses comprises another large category of low visibility income.

Growth of Passthrough Business Income

Passthrough business income has been growing steadily for 35 years to the point that it now produces almost as much income as corporations that pay tax directly (known as C- corporations).



Today there are about 7 million passthrough businesses with about $2 trillion in reported income. They exist in a tax limbo, because there is very limited third-party reporting of their income at the business entity level and negligible IRS examination activity to verify it. Fewer than one tenth of one percent of these businesses are audited.

An IRS study of one part of this universe of passthrough businesses indicated that their underreporting level was like that of sole proprietors for businesses up to a certain size. Another study by a group of economists using IRS data found that as much as 30% of partnership income could not be traced to any identifiable ultimate owners. Another important study by the National Bureau of Economic Research which came out recently concluded that unreported income in the top 1% of the income distribution is much greater than previously estimated and much of that income is buried in passthrough entities.

Continued Growth of the Tax Gap

The biggest part of the tax gap is driven by low visibility business income earned by the top income quartile of individuals, including in the passthrough businesses they own. The losses from this source have been growing every year and have largely not been addressed in any significant way. The opposite has happened, because over the last 25 years IRS enforcement resources have been cut 30% while the number of business returns have grown 80%.

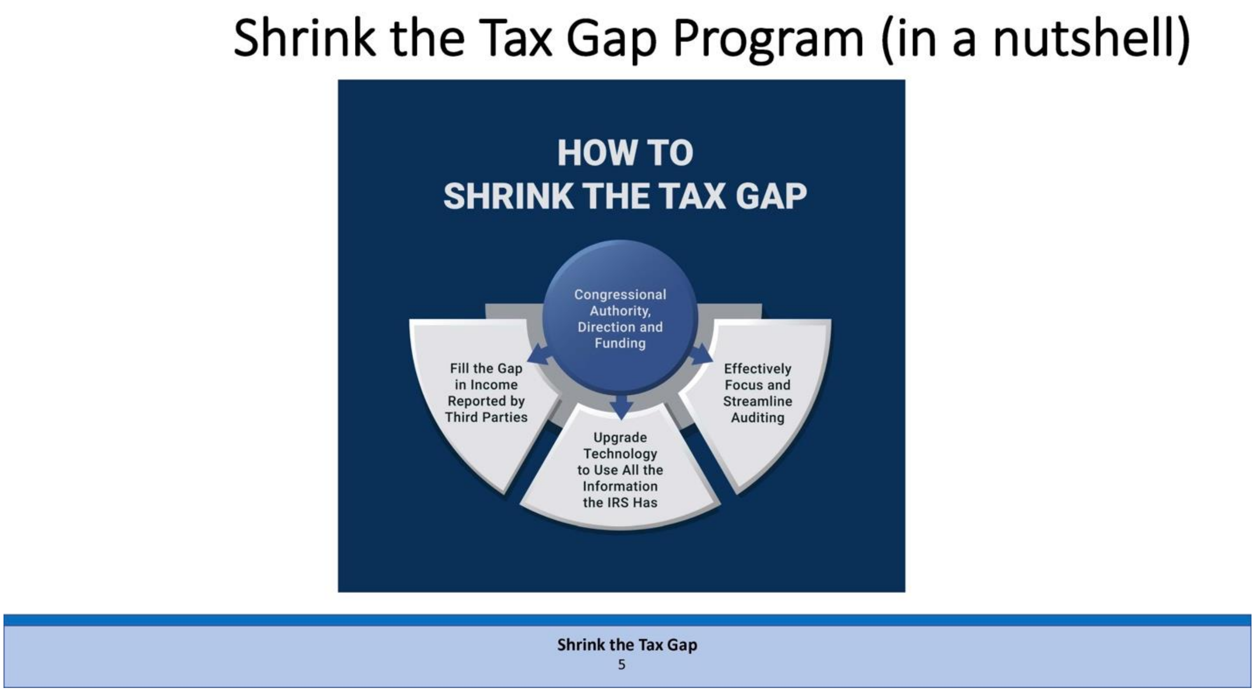
The only reason the tax gap is not even bigger is because most taxpayers have no meaningful opportunity to underreport since their income is in a highly visible form that is reported by third-parties and easily matched to their return. That still leaves a significant minority who have both the opportunity and the willingness to pay less than they owe, producing the ever-growing tax gap. The tax gap is not an even percentage with every taxpayer underpaying by some percent. It is a highly uneven percentage of underpayment based mainly on who is most easily able to underpay, so it is highly concentrated. Therefore, allowing it to continue to grow is very unfair to the vast majority of compliant taxpayers, who will bear all the burden of any tax increases while the non-compliant taxpayers bear little or none.

Shrinking the Tax Gap

Right now, the only IRS tool for collecting most underreported income is auditing. While more auditing is an essential part of any solution, auditing alone is not an adequate solution. Today, all IRS audit activity recovers less than 3.0% of the tax.

If we want to recover a substantial amount of the tax gap, we need to move more of the income from lower visibility categories to higher visibility categories.

With appropriate authority and funding from Congress, we believe there is a practical way to do this. It consists of three actions that build on what works best in the tax system today.



First, we need to fill in the gap in the sources of income reported to the IRS by third parties. Over the last year, in response to many comments, we have refined our STTG plan to make sure it proposes efficiently collecting the bare minimum of information we need and only from taxpayers with income sources and amounts that significantly contribute to the tax gap. (See "Updated Information Reporting Plan" on our website www.ShrinktheTaxGap.com)

Our plan would produce one new 1099 report on low visibility business income of individual taxpayers in the top quartile of income and the passthrough businesses they own. This 1099 would provide the taxpayer and the IRS a simple annual summary of deposits and withdrawals from their bank accounts. We estimate that slightly more than 13 million individuals and passthrough businesses would receive the 1099New, out of a universe of about 160 million individual and passthrough returns.

Second, we need to make more effective use of technology to use all the information the IRS has but cannot use efficiently, in addition to the1099New that we propose, to identify likely deficiencies in returns.

Third, we need to transform the auditing process to be the last step in resolving the deficiencies in returns that are identified and analyzed by technology.

It is the combined effect of all three of these elements that will produce a large and efficient reduction in the tax gap. The additional reporting helps the taxpayer file more accurately and provides the IRS the information to check the return efficiently. The technology allows the IRS to use its information to accurately identify likely deficiencies on returns and to increase the efficiency of the follow-up process. The transformed, data-driven audit process will allow the IRS and taxpayers to resolve cases promptly and efficiently.

Gain from Voluntary Compliance

IRS compliance studies universally show that third-party reporting actively used by the IRS for enforcement enormously improves voluntary compliance. Taxpayers who underreport income do so for many reasons, ranging from simple errors to sloppy bookkeeping, a belief that a little corner-cutting is not so bad, overly favorable interpretations of code provisions and outright evasion. More complete third-party reporting that is known to be effectively used by the IRS can positively affect all these factors. The desired and important result is simply to increase compliance without needing IRS intervention.

We estimate that about 68% of the revenue gain from our STTG plan would come from improved voluntary compliance. We believe this is a conservative estimate because it is a much lower ratio of voluntary versus enforced compliance than the tax system produces today for income with effective information reporting. Almost all taxes paid on income with high visibility from third-party reporting (over 98%) is paid without intervention by the IRS.

Streamlined Follow-up on Identified Deficiencies

Most of our estimated gain that requires intervention by the IRS comes from an enhanced matching and streamlined auditing process supplemented by some traditional auditing. Better use of data and technology greatly improves the follow-up process by more effective targeting and increased case productivity. You can see that difference clearly in this chart.

Return on Investment (ROI) for Major IRS Enforcement Programs *($ in millions)*

Enforcement Program	Cost	2018 Revenue	ROI
Examination	$3,716	$15,017	4.0
Automated Underreporter (Data Matching)	$208	$5,364	25.8

Source: IRS FY2020 Budget and Performance Plan

Shrink the Tax Gap
6

6

By the IRS calculation, traditional audit cases produce revenue equal to four times the cost, while data-driven matching programs like the AUR matching process produce 25 times. They are not perfect comparisons to our STTG plan, but the key point is valid: an entirely manual audit is far less efficient than a process that starts with data that can be analyzed with technology before handing it off to an employee.

The GAO reported in 2018 that the IRS Return Review Program, which uses modern technology to analyze all relevant information to screen returns for incorrect or fraudulent refund claims, had a revenue return of 15 times its cost.[1] The report recommended that approach be used on a broader basis to detect underreported income. That recommendation is exactly what the STTG plan is designed to do.

Unfortunately, even the current IRS data-driven programs, while efficient, are limited not only by lack of data in some areas but lack of sufficient current technology to make use of the data. That is why the technology component of our plan is critical.

GAO reported that the IRS could only process about 15% of the cases in which mismatches were identified. Some third-party data, such as 40 million K-1's reporting income from passthrough businesses, are only matched manually as part of an audit. Reports provided under FATCA by foreign financial institutions cannot currently be matched to taxpayer returns. And new technology would be needed to use the 1099New data we recommend and to make the follow-up auditing process more efficient for the IRS and the taxpayer.

[1] Government Accountability Office, GAO-18-544, July 2018. "IRS reported that between January 2015 and November 2017, RRP prevented the issuance of more than $6.51 billion in invalid refunds. As of March 30, 2018, IRS reports spending about $419 million developing and operating RRP."

Quality of Service and Taxpayer Rights

Assisting taxpayers to comply with the law and treating taxpayer fairly evenly when there is a dispute is a critical component of any program to achieve maximum overall tax compliance. Maximum voluntary compliance is the goal, and the easier it is for taxpayers to comply the more likely it is to achieve this goal.

Quality of Service

The technology we propose for our STTG plan would improve the quality of service to taxpayers in two ways that are most important to taxpayers: *prompt and efficient resolution of issues and avoidance of unnecessary audits.*

The technology and process improvements in our plan will allow taxpayers and the IRS to resolve any issues that are identified in a return more efficiently for the taxpayer and the IRS. Today, even a simple examination (called a correspondence exam) is often initiated by a letter from the IRS that is not clear or specific as to the issue or how to resolve the issue. Even these simple cases typically take more than six months to resolve. In addition, lack of adequate staffing and inadequate tools for employees often make it very slow or difficult to reach an employee who can resolve a case, even when the taxpayer wants to comply. The technology- supported STTG plan we propose will make IRS letters clearer, provide for a wider range of ways for IRS employees to communicate with taxpayers and provide the IRS employees better tools to resolve cases. The increased staffing resources called for in our plan will provide for an adequate number of trained employees to resolve taxpayer issues promptly.

A second improvement for taxpayers in our plan will be to reduce the number of so-called false positive audits, namely audits in which no deficiency is actually found. Such audits are unnecessary and costly to the taxpayers and the IRS, and today can be as high as 20% for individuals and even higher for businesses. These ratios might be even higher if cases where only immaterial amounts of deficiencies were counted. Proposed technology under our STTG plan would provide a much more effective and accurate way of identifying returns and issues on returns that need follow-up auditing. In addition, a part of our plan calls for the IRS to provide taxpayers a reconciliation schedule that can be attached to their return. This schedule allows taxpayers to explain in advance any differences between the amounts on information reports and those on their return, just as it does today for taxpayers with capital gains reported on a 1099B. This schedule would aid the taxpayer in filing an accurate return and in most cases should make an audit unnecessary. Audits of any kind are expensive for the IRS and the taxpayer, and reducing unnecessary ones is a key way to improve the burden of tax compliance on compliant taxpayers.

These service improvements are solutions to problems the taxpayer advocate has highlighted many times in her reports.

Taxpayer Rights

Taxpayer rights are protections that all taxpayers are entitled to and are mandatory for the IRS to observe whenever the IRS exercises its authority to audit a return or to propose a deficiency. As part of the STTG plan, taxpayer rights should be fully observed and where necessary clarified by law or regulation. Some of the most important rights that are relevant to our plan are:

> ***Issue Resolution Process.*** No taxpayer should ever be presented with a notice asserting a deficiency in tax without a prompt opportunity to communicate with a qualified IRS employee

who can explain the basis for the asserted deficiency and how it can be resolved. This is the intent of all the Shrink the Tax Gap proposals and is implicit in the service goals we propose. This commitment could be further clarified by law or regulation.

Appeal Rights. Right of appeal of an asserted deficiency to the IRS independent Appeals Office (recently strengthened by the Taxpayer First Act).

Burden of Proof on Assessments. Although courts have held that the IRS has the burden of proof in making a deficiency assessment based solely on third-party reporting, this rule should be mandated for internal IRS practice. To ensure implementation of this right, the IRS should provide taxpayers a process for identifying errors on information return

Recovery of Attorney's Fees. Clarify Eligibility for Small Business Taxpayers to Recover Attorney's Fee and increase limits on fees.

Access to Tax Court. Assure that taxpayer have access to tax court before paying assessments by allowing tax court power to accept jurisdiction on equitable grounds and include cases of penalties assessed by the IRS in the tax court jurisdiction.

Self-employed Access to VITA sites. Expand the jurisdiction of federal funded VITA sites to assist self-employed individuals

Revenue Gain

This chart shows our estimate of what our proposed approach could produce if it had been implemented starting in 2020 and how much it would cost in the IRS budget.

Shrink the Tax Gap
Summary of Revenue and Cost Estimates *($ in billions)*

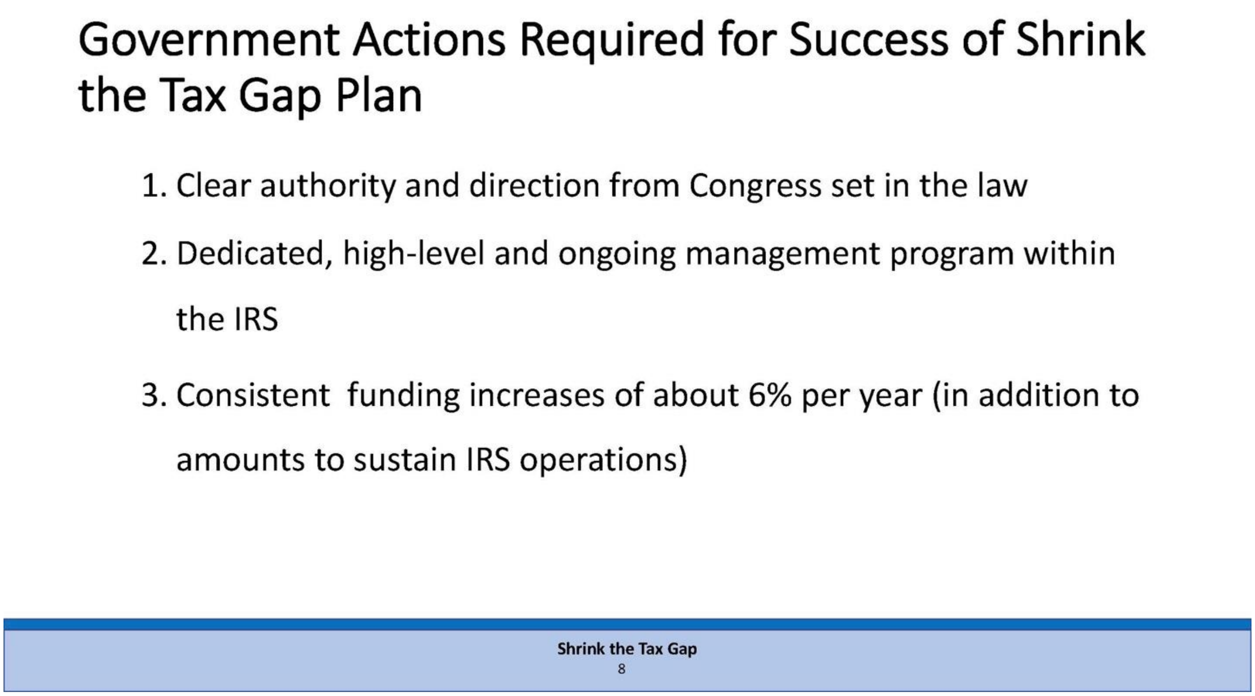
	2020	*2021*	*2022*	*2023*	*2024*	*2025*	*2026*	*2027*	*2028*	*2029*	***10-year Total***
Revenue Impact											
Unmitigated Tax Gap	*602*	*631*	*661*	*693*	*731*	*763*	*815*	*866*	*897*	*935*	**7,593**
Revenue Gain	*32*	*65*	*89*	*111*	*131*	*149*	*171*	*199*	*219*	*243*	**1,408**
Revenue Gain as % of Unmitigated Tax Gap	5%	10%	14%	16%	18%	20%	21%	23%	24%	26%	**19%**
Cost Impact											
IRS Base Budget	12.6	12.9	13.1	13.4	13.7	13.9	14.2	14.5	14.8	15.1	**138.3**
Total Cost Increment	0.7	1.8	2.8	4.0	5.4	6.9	8.9	10.1	11.5	11.7	**63.8**

(If proposal had become effective January 1, 2020)

Shrink the Tax Gap
7

We did not start with top-down numbers. Rather, with help from an expert revenue estimator, we estimated how much we could gain by moving the two lowest visibility categories of income to the next higher category source of income. All our calculations are shown in detail on our website (www.ShrinktheTaxGap.com).

Our estimate of the gain, although a large number ($1.4 trillion), still only recovers 19% of the tax gap over ten years. The gain builds gradually in our estimate, because we have been realistic about how fast the IRS could implement what we propose. Our recommended plan is a long-term investment, not a quick fix, but the gain would continue to build year after year as shown see in the chart.



To make our STTG plan successful, we believe it would take three major actions by our federal government.

1 Clear authority and a mandate from Congress set in the law is essential to provide a long-term commitment. Specific compliance and service goals, monitored by regular reports of milestones and metrics, can provide the basis for effective oversight and assure taxpayer rights. Our paper, "Goals, Metrics, Taxpayer Rights and Oversight*,"* provides details of how this could be done.

2 A dedicated, high-level, ongoing management program within the IRS will be required. In our *Tax Notes* article published on September 11, 2020, we have described how the IRS could successfully implement this plan.

3 Steady, assured funding is essential because the program requires investments in technology and staff that must be planned and executed over time. We estimate that additional funding on the order of 6% per year for ten years is required for implementation of the STTG plan. (This is in addition to that required to sustain IRS ongoing operations, restore adequate filing season services and modernize legacy systems.).

Summary

- We have a plan to shrink the tax gap by $1.4 trillion over 10 years.
- This gain is only 19% of the total 10-year tax gap.
- About 68% of the estimated gain is from increased voluntary compliance.
- The plan includes three actions that work together:
  - Fill the gap in income reported by third parties
  - Use modern technology to use all the information the IRS has and improve service
  - Scale up and transform auditing to be the last step in resolving cases identified by technology.

See our website (www.shrinkthetaxgap.com) for more details on our plan, including the basis for revenue and cost estimates.

Shrink the Tax Gap Information Reporting Plan

Revised Criteria and Process for Financial Service Provider Information Reporting of Low Visibility Income (1099New)

Revised April 15, 2021

Summary

A key part of our proposal to Shrink the Tax Gap is a new information report (1099New) to be provided by financial service providers (FSP's) on accounts held by taxpayers with low visibility income. This update simplifies the proposed process for individual taxpayers by limiting the report to taxpayers who have *both:* Adjusted Gross Income (AGI) over a set amount *and* low visibility income. It also eliminates the need for taxpayers to notify their financial service providers that their accounts should be reported as the IRS will notify the financial institutions directly of which accounts to report. An earlier version of the proposal indicated that taxpayers would need to notify their financial institutions.

Previous Proposal

The following excerpt from our September 14, 2020 article in *Tax Notes Federal,* entitled "Recover $1.6 Trillion, Modernize Tax Compliance and Assistance, the How To," summarized the previous proposal:

> "Taxpayers who have only income that's already reported to the IRS by employers, financial institutions or customers (on documents such as the familiar W-2 or 1099) wouldn't have to do anything except check a box on their return.
>
> **A. TCAM[2] Reporting Proposal**
>
> Taxpayers with more than $25,000 of business income would be required to list the account numbers of all their financial institution accounts on their returns. They would notify their financial institutions of the accounts they listed on their returns.
>
> The financial institutions that were notified by taxpayers would provide the taxpayer and the IRS a new 1099 summary report of total deposits received and total withdrawals made in each of these accounts.
>
> The taxpayer would attach a new schedule to their tax return,

[2] At the time, the September 14 *Tax Notes Federal* article was published, we referred to the current Shrink the Tax Gap proposal as Tax Compliance and Assistance Modernization, TCAM.

> reconciling the total amounts reported on the financial institution reports to the income and expenses reported on the tax return. For example, if the cash received in the financial institution accounts was greater than the income reported on the return, the schedule would itemize and explain the differences.
>
> More details on the TCAM proposed financial institution and taxpayer reporting is provided in Appendix E, Taxpayer Burden Estimate, on our web site TCAmodernization.com." (Rossotti/Forman 1366)

Updated Proposal

As a result of comments and suggestions from reviewers of our previous article, we decided to change the criteria and process for producing the 1099New information report. We have continued to refine this process as we receive comments and suggestions. The content and use of the report itself would be the same.

Individual Filers

The report would be required for individual taxpayers whose income was in the top 25% of all filers *and* who had income from low visibility sources[3]. Using these criteria, the 1099New report would be provided for about 5% of all individual filers and about 20% of those with sole proprietor income.

Passthrough Entities

The report would also be required for all passthrough entities who had an ownership interest held by the individual taxpayers above the designated income level.

Process

The IRS would be responsible for determining which taxpayers (individual filers and passthrough entities) would be covered by the 1099New reporting requirement. The IRS would analyze all individual and passthrough returns filed in the previous tax year, determining which returns qualified for the information reporting based on AGI limit, presence of low visibility income and ownership interest in passthrough entities.

Treasury regulations would specify the types of accounts and financial service providers that are covered by the reporting requirement.

A. The IRS would provide the financial service providers limited access to an encrypted file of

[3] In our analysis we used Adjusted Gross Income (AGI) as an indicator of individual income because IRS statistics are most readily available using this definition. However, we recommend allowing the IRS flexibility as to the precise definition of income it would use to identify taxpayers who would receive the 1099NEW. For example, the IRS sometimes uses a definition of business income that adds back loses to reported income because returns that report high positive income offset by losses often have significant non-compliance issues

the taxpayer ID numbers (SSN or EIN) designated to receive the 1099NEW report.

B. The financial service providers would provide the designated taxpayers and the IRS a 1099New report for all the identified accounts the following year in the same manner as for all other 1099's.

The 1099NEW rules would apply to financial service providers, which we suggest include:

- Banks and traditional financial institutions that enable individuals to make and receive payments and hold balances
- Online payment systems and mobile payment apps that permit individuals and companies to make and receive payments and hold a balance that is not always reflected in the traditional banking system.
- Cryptocurrency exchanges

These rules would cover both FDIC-insured institutions as well as financial service providers not covered by the FDIC. We believe that this definition provides a level playing field and helps accomplish our goal of identifying low-visibility income by covering not only the traditional ways that individuals and businesses execute financial transactions but also the new, technology-driven payment mechanisms that will only become more common in the future.

This process would apply to US-based financial service providers, including US subsidiaries of foreign financial institutions. The IRS already obtains information on accounts in non-US foreign financial institutions under the Foreign Accounts Tax Compliance Act (FATCA and would make use of this FACTCA information in its compliance program.

Taxpayers who receive the 1099New would use the information return in the same way as all taxpayers use 1099's, (such as for securities transactions or interest income), to assist in filing an accurate return. The IRS would provide taxpayers a reconciliation schedule that would allow taxpayers to reconcile the 1099New's with their return, just as the IRS provides a supplementary schedule (Form 8949) that allows taxpayers with capital gains to reconcile their tax return with amounts reported on the 1099B information return[4].

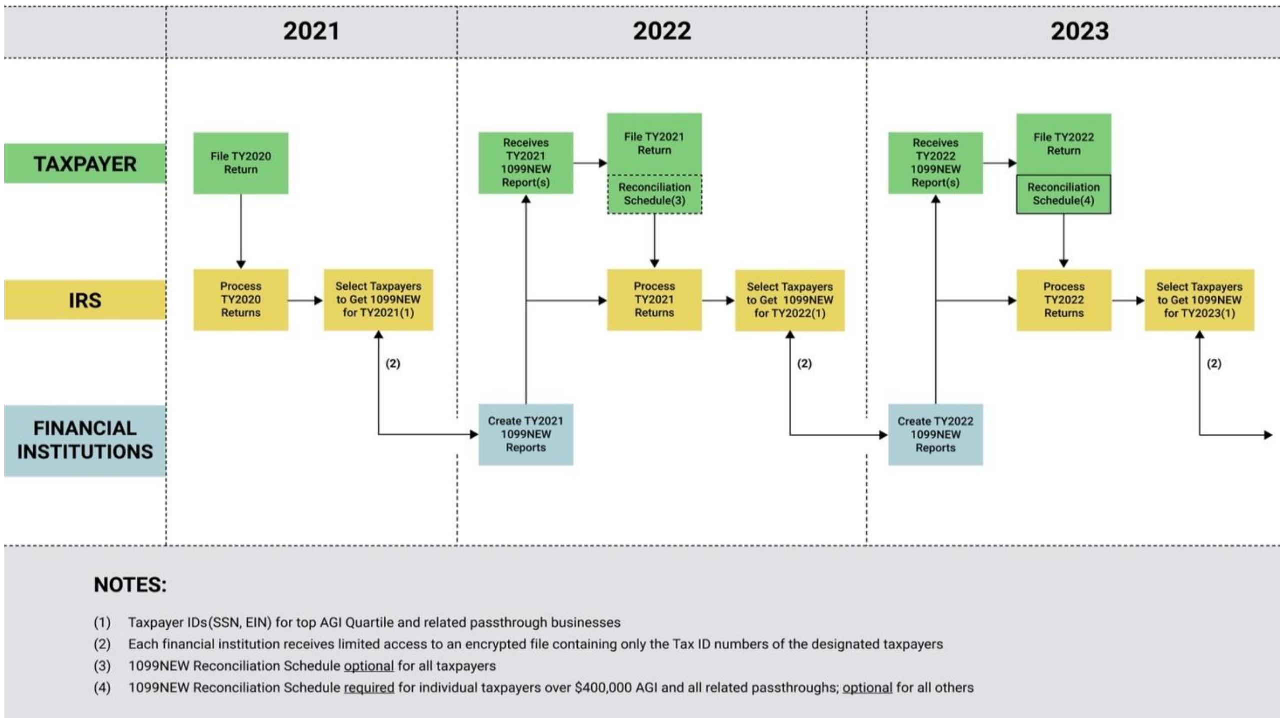
This schedule is explained in detail in Appendix E on our website https://www.shrinkthetaxgap.com/. As discussed in the section titled "How Much of a Burden Would this Be" in our September 14, 2020 *Tax Notes Federal* article, this schedule would benefit both the taxpayer and the IRS by explaining in advance any potential discrepancies, thereby reducing the likelihood of unnecessary follow-up audits. Unnecessary audits, those in which no change or a trivial change in the tax liability is the result, is a serious source of frustration for taxpayers and inefficiency for the IRS.

The reconciliation schedule would be optional for all taxpayers and would be required after a one-year delay for individual taxpayers with AGI over $400,000 and all related passthrough entities.

The following figure (also in Exhibit 14 on our website) shows how this new information flow would be implemented over a three-year period:

[4] IRS instructions to Form 8949 explains its purpose as follows: "Form 8949 allows you and the IRS to reconcile amounts that were reported to you and the IRS on Forms 1099-B or 1099-S (or substitute statements) with the amounts you report on your return."

1099NEW Information Report Timeline



We have constructed several scenarios to illustrate how the 1099New information reporting and reconciliation schedule would apply to taxpayers in typical situations. These are shown in Exhibit 15 on our website.

Considerations Affecting this Proposed Method

Any additional information reporting will impose some requirements on some taxpayers and on the reporting entities and will involve the exchange of personal financial information between the reporting entities and the IRS. Our goal has been to obtain the required information in a method that, taken as a whole, balances three key considerations:

- Provides the new information reports to the universe of taxpayers who have the predominant amounts of underreported income while avoiding unnecessary reporting on other taxpayers.
- Minimizes the taxpayer information exchanged to and from the reporting entities and ensures the protection of any information exchanged.
- Provides reliable information to the IRS that can be used effectively to shrink the tax gap.

An important fact in weighing these considerations is that the IRS needs the new information report on fewer than 10% of the universe of individual and business taxpayers, (approximately 13 million individual and passthrough business taxpayers out of a universe of about 160 million) but it does need as complete a view as possible of the accounts of those taxpayers who do receive the reports. Reporting which omits a significant fraction of a taxpayer's financial accounts is not useful for the IRS and could mislead taxpayers receiving the partial information.

A more traditional method of producing 1099's would delegate to financial services providers the role of selecting which taxpayers would receive the 1099's based on such criteria as the dollar value or dollar inflow to an account. Because the need for information in the STTG plan is limited to a relatively small subset of taxpayers, any such general method would provide information reporting on many more taxpayers than required, while failing to produce complete information on those taxpayers whose income is not otherwise reported. Our proposed method will reliably provide the additional information reporting to only those taxpayers whose income is not otherwise reported, thereby minimizing any overreporting or confusion on other taxpayers.

Privacy and Security Safeguards

The information provided by the IRS to the financial service providers specified in Treasury regulations in order to designate which taxpayer accounts should receive the 1099NEW would be subject to legal and technology-based safeguards to protect against any misuse of this information. Some of the safeguards would be the following:

- Financial service providers receiving access to the information are all entities that receive and maintain large quantities of sensitive information as a part of their basic operations. They are subject to oversight and compliance checks on their processes to safeguard this information.

- The information provided by the IRS would be provided under regulations specifying that the information could only be used for the purpose of designating accounts to receive the specified 1099NEW and for no other purpose.

- The information provided by the IRS would contain no financial information, only the bare minimum needed to identify the designated accounts.

- The computer file containing the IRS information would be retained under the control of the IRS at all times. Each financial institution would receive limited, controlled and secure access to this file for a limited time needed solely to identify which of its accounts are designated to receive the 1099NEW.

- Each financial institution would only be able access the IRS information to identify which of its own accounts were designated to receive the 1099NEW. It would not have access to any information at all on accounts held at other financial institutions.

- All access to the IRS information would be tracked and logged.

Technical details on the method of by which financial institutions would access the necessary information is provided in Appendix F.

Financial Results with Revised Information Reporting Criteria

Our methodology for making our revenue estimates is explained in Appendix A, *Calculating the*

Revenue Impact, and in Exhibits 1, 3 and 4, on our website.

The revised criteria for defining which taxpayers receive the 1099New information report would change our estimate of the revenue gain from our initial proposal because only taxpayers with more than the designated AGI would receive the report, even if they had significant low visibility income below the AGI threshold. Taxpayers with income below this threshold would of course still be legally required to report all their income and would be subject to traditional enforcement procedures, but the IRS efficiency in enforcing compliance would be reduced.

By setting the threshold at an AGI level equal to the top 25% of individual taxpayers, we believe we would cover approximately 62% of underreported low visibility income on individual returns, while minimizing the number of information reports. We also estimate that requiring the 1099New report for passthroughs for entities with an ownership interest held by the top 25% of individual taxpayers would cover approximately 97% of **income** from passthrough entities. (See Exhibit 12, Backup for Information Reporting, on our website.)

Using these criteria, the estimated revenue gain over 10 years from individual taxpayers would be reduced by about $180 billion, from $929 billion to $749 billion. The calculations for this estimate are shown in our revised Exhibit 3-1, Tax Gap Gain from Individual Taxpayers, Adjusted for AGI Class, on our website.

We also analyzed the effect of this change in reporting on the estimated gain from passthrough entities, as detailed in Exhibit 4-1, Tax Gap Gain from Passthroughs, Update One, on our website. We concluded that there is no need to change the original estimate of the gain, since about 97% of the income of passthroughs is earned by the top 25% of individual taxpayers.

In addition, our initial analysis did not include any gain from passthroughs with gross receipts over $25 million because we assumed that these large passthroughs were all technically compliant. On further analysis, by extrapolation from the prior IRS study of S corporations, we concluded that some gain, amounting to approximately six tenths of one percent of income, would be found by the additional reporting on these large passthroughs.

Finally, we did not include any estimated gain from the application of our technology-enhanced matching process for partnerships owned by other partnerships (so-called tiered partnerships), although prior studies have indicated that as much as 30% of partnership income is not traceable to any taxable return[5]. The technology we propose would be capable of identifying where this missing income is going.

We did not assume any change in the estimated cost for the IRS to execute our proposed program.

The technology program would be unchanged except for a minor change in how the 1099New report would be obtained from financial institutions. The new method would actually be simpler for the taxpayer and the IRS.

With respect to IRS staffing, there would be somewhat fewer matching cases under the new criteria for information reporting because a smaller fraction of individual taxpayers would receive

[5] Cooper, Michael et al., “Business in the United States: Who Owns it and How Much Tax They Pay.” *Tax Policy and the Economy, Number 30,* The University of Chicago Press. © 2016 by the National Bureau of Economic Research.

the 1099New report. However, we did not assume any reduced staffing requirement because we assume some staffing would be required to perform selective audits on taxpayers below the threshold for receiving the 1099New.

The net effect of these assumptions is to slightly reduce the estimated revenue gain and the estimated efficiency of the overall plan. The overall result of the proposal using the revised reporting criteria is as follows:

$ in billions

	2019	*2020*	*2021*	*2022*	*2023*	*2024*	*2025*	*2026*	*2027*	*2028*	*2029*	*10-year total*
IRS Base Budget	$12.3	$12.6	$12.9	$13.1	$13.4	$13.7	$13.9	$14.2	$14.5	$14.8	$15.1	$138.3
Technology Cost Increment		0.1	0.4	0.5	0.7	0.9	1.3	1.7	2.0	2.2	2.3	12.0
Staffing Cost Increment		0.6	1.4	2.3	3.3	4.4	5.6	7.2	8.2	9.4	9.4	51.8
Total Cost Increment		0.7	1.8	2.8	4.0	5.4	6.9	8.9	10.1	11.5	11.7	63.8
Revenue Gain		32	65	89	111	131	149	171	199	219	243	$1,408
Ratio: Revenue Gain to Cost Increment												22
Unmitigated Tax Gap		602	631	661	693	731	763	815	866	897	935	7,593
Revenue Gain as % of Unmitigated Tax Gap		5%	10%	14%	16%	18%	20%	21%	23%	24%	26%	19%

Taxpayer Impact

Appendix E Version 2: Taxpayer Impact
April 18, 2021

Note: This update replaces an earlier version of Appendix E in its entirety.

Reason for Update

Update 1 to our Shrink the Tax Gap plan updated and narrowed the criteria for which taxpayers would receive the 1099NEW information report and eliminated the need for taxpayers to notify banks about their accounts. These changes also reduced our estimate of the 10-year revenue gain by approximately $200 billion, because the estimated revenue gain would be limited to the top quartile taxpayers. Because of these changes and other comments received on our original proposal, the method used to estimate taxpayer impact in our original Appendix E is no longer valid and is being replaced by Version 2.

Who Would Receive the 1099New Information Report?

The 1099NEW information report would be provided only to individual taxpayers who have income in the top quartile (i.e., top 25%) of Adjusted Gross Income (AGI) **and** who have business income not reported on other 1099's. It would also be provided to passthrough businesses that these top quartile taxpayers own.

AGI is a frequently used measure of taxpayer income as it allows for certain deductions in stating income. The cutoff for the top quartile of taxpayers was estimated to be about $92,000 AGI in 2020 and will increase each year. We estimate that approximately 13 million individual and passthrough taxpayers would receive the 1099NEW, out of a total universe of about 160 million individual and passthrough returns.

The 1099NEW would show total annual deposits and withdrawals from each of the taxpayer's bank accounts over the course of a calendar year.

Individual and passthrough taxpayers would receive the 1099 from financial institutions who hold their depository accounts as they do all other information reports. They would not have to do anything to receive these reports.

The universe of financial institutions and types of accounts to be reported on would be defined by Treasury regulations and would include not only commercial banks but other financial providers who regularly accept and process financial inflows and transactions.

Reconciliation Schedule

Summary Description. The IRS would provide instructions and a supplementary information schedule that would allow taxpayers to reconcile their total withdrawals and total deposits from the 1099NEW reports to their business gross income, business deductions, and net income or loss. This schedule would aid the taxpayers and their preparers to prepare an accurate return and would eliminate the need in many cases for the IRS to audit a tax return, thereby saving the taxpayer and the IRS significant time spent in unnecessary audits

This schedule is similar to the schedule the IRS provides to taxpayers (Form 8949) to allow them to reconcile their capital gains income as reported on the tax return to amounts reported on information returns 1099-B.[6] Form 8949 provides a set of codes allowing the taxpayer to designate amounts that are reported on the 1099B that are not required to be reported as gains on the tax return. That is the same process that would be used on the STTG proposed reconciliation schedule.

Schedule Optional for Most Taxpayers. The filing of the reconciliation schedule would be optional for any individual taxpayers with AGI under $400,000. Taxpayers with AGI over this limit and who receive the 1099NEW and report the income on their individual returns would be required to file the reconciliation schedule. We estimate that requirement would cover approximately 1% of all individual tax returns and about 20% of those who receive the 1099NEW. It would also be required for most passthrough businesses since most of them are owned by top quartile taxpayers.

Personal Accounts Excluded. The reconciliation schedule would provide for taxpayers to designate any bank accounts that did not include business receipts or deductions as personal accounts and to exclude them from the reconciliation schedule for simplification purposes.

Schedule Details. The reconciliation schedule would allow the taxpayer to identify and explain adjustments to deposits that do not constitute income, such as deposits from non-business income, or loans and adjustments to withdrawals that are not allowable business deductions, such as personal use withdrawals or return of owner capital.

The adjusted amounts of deposits and withdrawals would reconcile to the appropriate line items on the tax return schedule.

A reconciliation schedule would be done for business income (e.g., Schedule C, E or F) on an individual tax return and at the entity level for passthrough entities.

The data from the 1099NEW and the process of reconciling it would aid the taxpayer or his preparer in filing an accurate return by checking that all appropriate receipts are included in income and that only appropriate deductions are used.

The reconciliation schedule would only need to cover significant items causing a difference between the 1099NEW and the return and would not need to balance to the penny. It would not require transaction-level detail, only general categories, such as “non-deductible personal expenses” in reconciling withdrawals, or “gifts” in reconciling deposits. These categories would be similar to the codes provided for in the instructions to the Form 8949 reconciliation schedule. Most taxpayers covered by this requirement are cash- basis taxpayers, but the schedule would also provide for taxpayers who report on an accrual basis.

How the Reconciliation Schedule Would Be Prepared

The providers of tax preparation software would incorporate the 1099NEW and the related IRS reconciliation schedule into their software. The software would

[6] The instructions to Form 8949 state that “Form 8949 allows you and the IRS to reconcile amounts that were reported to you and the IRS on Forms 1099-B or 1099-S (or substitute statements) with the amounts you report on your return.”

allow the preparer to enter or directly upload the 1099NEW just as they do for all other 1099's. After the associated tax return schedule (e.g., Form 1040, Schedule C or Form 1065) was prepared, the software would then prompt for or require adjustments necessary to prepare the reconciliation schedule, which would be filed as part of the tax return.

In order to allow software providers, preparers and taxpayers adequate time to prepare the reconciliation schedule efficiently, for those taxpayers required to file the reconciliation schedule, the requirement would be delayed for one full tax year after the first year in which the taxpayers would receive the first 1099NEW. This would allow sufficient time for taxpayers who file the schedule to identify any transactions in their records so they could be retrieved and used at the end of the year to prepare the schedule for the following years.

Cost to the Taxpayer

There would be no cost to the taxpayer to receive the 1099NEW, as it would be provided by the taxpayer's financial institution just as any other 1099. The only additional requirement for the taxpayer would be preparation of the reconciliation schedule to be filed with the return by high income individual taxpayers (those with AGI over $400,000) and for passthrough business entities.

According to the annual survey by National Federal of Independent Business (NFIB), 88% of their members use preparers for their returns, and we believe almost all high-income business taxpayers use preparers with automated systems to maintain business records and to do tax return preparation. All bank accounts of passthrough businesses have separate tax ID numbers and we believe that almost all the high-income individual taxpayers who would file the reconciliation schedule would maintain separate accounts for their business activities. Since filing the reconciliation schedule would be delayed for a full tax year after first receiving the 1099NEW, preparers would be able to identify any transactions in their systems of record that would be required to prepare the schedule. Taxpayers could also take advantage of this delay to reconfigure their bank accounts to simplify the process.

Based on published surveys and informal discussions with software providers and preparers, we are working on estimating how much the reconciliation schedule would increase the cost of preparing a business return. We do not yet have this data but will publish it if we can get reliable data.

Whatever the cost to the taxpayer, preparation of business tax returns is a deductible business expense.

Goals, Metrics, Taxpayer Rights and Oversight

May 4, 2021

Direction and High-Level Goals set by Congress

Shrink the tax Gap is a long-term program involving major change in how the IRS does business and how it interacts with taxpayers. It encompasses increased information reporting, investment in modern technology, and modernized enforcement processes. From Congress, these changes will require clear direction and goals, sustained long term funding and continuing oversight. The IRS in turn will have to provide data to measure progress and to provide a basis for oversight.

This paper shows how goals and measurements of progress for the program could be articulated and used for oversight by the administration and Congressional Committees

A Successful Example: Electronic Filing

An example of how the goals for the Shrink the Tax Gap program could be stated is the IRS Restructuring and Reform Act of 1998. This law was passed after a year of study of the IRS by a bi-partisan Congressional panel. It prescribed and authorized many significant changes, including a key one requiring the IRS to convert to electronic filing of tax returns, set in the law as follows:

> (a) IN GENERAL—It is the policy of Congress that—
> (1) paperless filing should be the preferred and most
> convenient means of filing federal tax and information returns;
> (2) it should be the goal of the Internal Revenue Service
> to have at least 80 percent of all such returns filed electronically
> by the year 2007; and
> (3) the Internal Revenue Service should cooperate with
> and encourage the private sector by encouraging competition
> to increase electronic filing of returns.

At the time this law was passed, electronic filing at an early stage, but today the tax system could not function without it. The program required major behavioral change by taxpayers and technological change in the IRS and had to overcome many obstacles over the subsequent 20 years. A key element in allowing it to succeed was the clear mandate and direction set in law.

The goal stated in the legislation of 80% electronic filing seemed clearer than it actually was and required more definition by the IRS to make it operational. These more specific metrics were developed by the IRS following guidance from hearings and studies that both preceded and followed the legislation.

Through all the challenges and changes, the clear mandate in the law provided the direction the IRS needed to continue making progress.

Congressional Direction and High-Level Goals for the STTG Program

Following the pattern set in the Restructuring and Reform Act of 1998, we suggest formulating the IRS mandate for the STTG program in a form such as:

"It is the policy of Congress that----

1. Compliance
    a. Goal. It should be the goal of the IRS that, by the tenth tax year after the effective date of this statute, the net tax gap, as measured by the fraction of taxes due that are not reported and paid, should be reduced by at least 20%, as compared with the fraction estimated in the most recent IRS study prior to enactment of this statute.
    b. Priorities. Priorities for actions and resources to improve compliance should be guided by the relative dollar amounts of non-compliance.

2. Service
   Goal. It should be the goal of the IRS that the quality, timeliness and accuracy of assistance provided to taxpayers interacting with the IRS be comparable to that provided by leading private financial services institutions.

3. Reporting
    a. Within one year of enactment, the IRS will prepare a plan to achieve the compliance and assistance goals and will define milestones and metrics indicating progress on achieving the goals. Milestones and metrics must be reported at least annually indicating progress in executing the plan.
    b. In addition to reporting annual milestones and metrics, within three years after the effective date of this statute and every two years thereafter, the IRS shall present a comprehensive quantitative and qualitative report evaluating progress towards these goals and reporting changes to the overall plan."

Compliance Goal. A formulation in this manner would ensure that the IRS would seek to steadily reduce the tax gap and improve assistance to taxpayers, but also would focus its highest priority on taxpayers that are responsible for the largest dollar amounts in the tax gap. The compliance goal is largely independent of fluctuations in the level of revenue collections because it is defined as improvement in the fraction of taxes due that are paid rather than any absolute amount. As shown in past IRS compliance studies, this fraction has remained relatively stable over time in the absence of effective IRS actions to reduce it.[7]

Service Goal and Taxpayer Rights. Although we call the program Shrink the Tax Gap (STTG), our proposed improvements in IRS's business processes and technology would also improve the

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[7] In four IRS compliance studies in time periods from 2001 to 2013, the voluntary compliance rate varied in a very small range, a maximum of 1.3%. See Figure 2 in Internal Revenue Service (IRS) Research, Applied Analytics & Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013*, Publication 1415 (Rev. 9-2019), Washington, DC. This ratio is driven primarily by the level of information reporting and IRS follow-up on identified deficiencies, both of which were relatively constant in that period. This is what STTG aims to change

taxpayer experience in all aspects of their dealings with the IRS. The taxpayer experience encompasses two aspects taxpayer service and taxpayer rights. Both are essential to achieving voluntary compliance and fairness to all taxpayers.

A high quality of service whenever a taxpayer interacts with the IRS is essential so that taxpayers who are trying to comply can do so efficiently and without undue time or stress. For this reason, we include a service goal on par with the compliance goal. Taxpayer rights are a mandatory aspect of the IRS dealings with the public whenever it asserts its authority to enforce compliance.

To support the improvement in taxpayer experience and ensure adherence to taxpayer rights in the compliance process, approximately 24% of the STTG estimated staffing costs are allocated to taxpayer education, prefiling service support and taxpayer rights function such as appeals and taxpayer advocate.

Reporting and Oversight. Clear and consistent reporting is essential to effective oversight by both the executive branch and Congressional Oversight Committees. This requirement will be aided by defining and incorporating an appropriate reporting process into the IRS mandate.

Once a clear mandate and direction such as suggested above is set into law, the IRS will propose specific programs and resources to accomplish the goals, including defining appropriate milestones and metrics to indicate progress. This framework would enable both Congress and Treasury to perform their critical oversight function. The following discussion shows how these milestones and performance metrics could be defined. This discussion focuses on measurements that would be newly developed or updated to be relevant to the goals of the STTG program.

In considering the specific milestones and performance metrics we recommend, we want to emphasize four points:

1. This kind of change cannot happen over-night. Successful implementation will require long-term funding commitments and consistency in much needed Congressional and Executive Branch oversight.

2. While modernized enforcement strategies including increased audit coverage will be necessary, the primary driver of shrinking the tax gap will be the improved voluntary compliance that flows from enhanced information reporting supported by modernized technology. Approximately 68% of our estimated revenue gain is from voluntary compliance.

3. Meeting industry standard service levels an essential element of improving compliance and one that can and should be implemented on a far more rapid time.

4. Since the STTG program focuses on reducing underreporting of income, it important for taxpayer rights related to this aspect of the IRS process be clarified and fully monitored. (This is discussed more fully below.)

Milestones and Performance Metrics

The reported data should fall broadly into two categories: Milestones and Performance Metrics.

Milestones

Milestones reflect a point in the STTG program when a specific improvement in IRS operations or services has been achieved and that indicates progress in implementing the overall plan. An example of an early milestone would be for the IRS to implement the procedures to exchange information with banks needed for the 1099NEW and to receive the 1099NEW. A high-level list of possible milestones for the proposed compliance plan is as follows:

Business Process Milestones

Date		*Milestone*
≥ 3 months before Year-1	A	Congress Passes STTG Program Enabling Legislation
January Year-1	B	STTG Program Start; Program Planning Phase
July Year-1	C	Start Selected Workstreams; Taxpayers Begin Notification to Banks of Business Accounts
January Year-2	D	First Filing Season Accepting New Bank Information Returns and Reconciliation Schedule
July Year-2	E	Select Initial Business Returns for Traditional Examination
July Year-3	F	Initial Return Analysis Model Trained Using Business Returns (subsequent models trained every six months)
July Year-3	G	STTG Accepts First Business Returns for Matching Analysis Using Initial Analytical Models
July Year-4	H	STTG Accepts First Business Returns for E-Exam Analysis Using Initial Analytical Models
July Year-5	I	STTG Accepts First Business Returns for Field Exam Analysis Using Initial Analytical Models
January Year-6	J	RRP Converted to STTG Platform for Case Management (with new models)
August Year-7	K	Initial STTG Tax Gap Estimate
August Year-7	L	Multi-Format Searchable Database in Production
February Year-8	M	Legacy AUR System for Matching Sunset Complete
August Year-8	N	Legacy System for Remote Exam Sunset Complete
February Year-9	O	Legacy System for Field Exam Sunset Complete

The STTG planning process would be an essential foundation for the program. An initial plan would be produced by the IRS and updated regularly. At each update, the list of milestones for the near-term years would be expanded, usually including two to three meaningful milestones each year. The milestones would be updated each year to reflect updates to the plan and to add to the near-term list of milestones.

Performance Metrics

Performance Metrics are numerical indicators of progress toward the IRS broad compliance and service goals as mandated by Congress.

Compliance Metrics

The major long-term measure of success for the compliance program is the fraction of taxes due that are paid and collected after considering IRS intervention. This is referred to as the Net Compliance Rate (NCR), which is defined by the IRS as follows:

> "The net compliance rate (NCR) is defined as the sum of all timely and enforced and late payments divided by total true tax, expressed as a percentage."[8]

In the last full IRS study, the NCR was 85.8 % and the net tax gap percentage was therefore (1-85.8%) or 14.2% of the total amount of tax legally due. To get to the overall goal of a 20% reduction after ten years the net tax gap percentage would have to go down from 14.2% to 11.4%.

While this broad measure is the most meaningful measure of compliance in the tax system in the past it has been available only sporadically after periodic IRS studies. The most recent study concluded in 2013. Furthermore, it is a composite that summarizes a number of sub-elements such as underpayment, underreporting and non-filing for each type of tax (individual income tax, corporate tax, etc.).

The IRS compliance studies also compute a ratio, called the Net Misreporting Percentage, (NMP) which specifically measures the underreporting of different sources of income in the individual income tax, which is the largest component of the tax gap and is the major focus of the STTG program.[9] The NMP is the metric that shows large variations in compliance are driven by the level of information reporting

Our recommended long-term STTG compliance program would build on these sound measurement concepts but would use them to provide more current and useful compliance metrics on an on-going basis. This would be possible as a by-product of the proposed transformed compliance approach which would use greatly enhanced technology to evaluate every return as it was processed using all available information, including enhanced information reporting and machine learning models.[10] This automated process would usually analyze returns and follow up on issues in the same year they were processed, greatly increasing the timeliness of available data. Some traditional auditing would be needed to train the machine learning models as well as to follow up on certain types of

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[8] Internal Revenue Service (IRS) Research, Applied Analytics & Statistics*, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013*, Publication 1415 (Rev. 9-2019), Washington, DC.

[9] Our STTG program would also include underreported self-employment tax related to underreported income.

[10] This process is described in detail in *Tax Notes* article, "Recover $1.6 Trillion, Modernize Tax Compliance and Assistance: The How-To," published Sept 14, 2020, and at www.shrinkthetaxgap.com, Appendices B and C.

cases. From this large amount of data, rolling samples could be used to track compliance trends at least annually.[11]

Our proposed plan breaks the work of building models and analyzing returns into an estimated 16 return analysis models which would be implemented incrementally over a ten-year period. The actual number of models would be increased or decreased as the IRS gained experience with this approach.

Each of these models would represent a subcategory of underreporting. For example, one model might focus on underreporting of rental income, which is in now in the lowest visibility category with a Net Misreporting Percentage (NMP) of 51%. Another model would focus on matching k-1's reporting passthrough income to taxable returns, which has an NMP of 11%. Each model would include tracking statistics to estimate trends in compliance as measured by the Net Misreporting Percentage, both as filed and after IRS intervention.

The trend in this ratio would provide the basis for measuring progress towards improving compliance (including the effect of both voluntary compliance and enforcement activities).[12] Over time these could be aggregated to estimate overall reductions in the Voluntary Compliance Rate and the Net Compliance Rate for all underreported income for the individual income tax.

While not proposed explicitly as part our STTG plan, a similar approach could be taken by the IRS to measure trends in non-filing compliance.

In addition, TIGTA and GAO produce reports analyzing compliance levels for certain sensitive categories of taxpayers. These reports provide additional baselines against which the IRS could periodically re-estimate compliance trends in these categories. For example, a recent TIGTA report provided could be used as a baseline of non-filing by high income taxpayers.

In summary, the IRS would produce measurements of the change in the compliance ratios of various subcategories of taxpayer income regularly, beginning approximately two years after the start of the program. Broader aggregated measures should be possible approximately three years after the start of the program and a full annual tax gap report should be possible after five to six years.

The critical consideration in the compliance program is to develop performance metrics that align with the major goal, which is to improve overall compliance results with improved voluntary compliance as well as revenue from enforcement actions. We believe the program we recommend can produce performance metrics that are properly aligned with that goal and are reasonably indicative of progress or lack of progress, even if they are partial or imperfect in the early periods.

Another category of performance metrics indicates performance in direct interactions with taxpayers. These are commonly referred to as "customer service" metrics, and they are in many respects

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[11] The IRS is already working on approaches similar to this. In a recent memo, Commissioner Rettig noted, "In an effort to provide more frequent and timely updates, RAAS is actively developing methods to 'forecast' the Tax Gap in advance of actually reporting compliance data and then revising the estimates as actual data are later collected and analyzed. These new approaches and methodologies designed by RAAS would enhance the currency of future Tax Gap estimates as well as identify possible additional sources contributing to the Tax Gap."

[12] Although these ratios would be subject to some estimation error, this error would decrease over time as the IRS processed and sampled more returns in each subcategory from the return analysis process. The IRS would also be able to provide statistical analysis showing the level of significance of changes in the estimates.

comparable to metrics used in commercial businesses, including financial services businesses. They can apply to taxpayer interactions that occur through different channels, such as phone calls, traditional mail, or increasingly through electronic communications. The IRS already produces many of these metrics and reports on them to the public and to Congress.

Compliance-related interactions

Compliance interactions related to underreporting of income are the primary focus of the STTG plan. A fundamental aspect of this plan is to transform the majority of interactions with underreporting taxpayers to a faster and more efficient process of identifying and resolving potential underreporting issues than now occurs in traditional audits. The IRS would have the responsibility to use all the information it already has to analyze returns and identify possible deficiencies before contacting the taxpayer. The interaction with the taxpayer should be faster, more efficient in use of the IRS and the taxpayer's time and focused on resolving any specific issues identified by the process.

Service performance metrics for this process should be broadened to include, for example: (1) *the fraction of false positive cases* (i.e., cases with no or minimal change in tax); (2) *the taxpayer's view of the clarity and quality of notices; (3) quality, timeliness and accuracy of calls and other interactions* (as measured by surveys); and (4) *the time to resolve cases.*

The previous discussion is not a comprehensive specification of all service and assistance metrics but is intended to illustrate the kinds of new or updated metrics the IRS should produce as part of its modernization of business practices and accompanying funding.

Taxpayer Rights

Unlike compliance and service goals for the IRS, taxpayer rights do **not** represent a goal for the IRS. They are a **mandate** that the IRS must adhere to, just as taxpayers are expected to adhere to the law. Many taxpayer rights are already included in law or regulations but many of those relate to the IRS process for collecting amounts known to be owed by the taxpayer. The STTG compliance process is aimed at identifying income not properly reported on tax returns and resolving those likely deficiencies with taxpayers through follow up enforcement processes of various kinds.

We believe that several key taxpayer rights do already apply in these situations but some of these rights may need to be clarified by regulation, and all should be regularly monitored by the independent Taxpayer Inspector General of Tax Administration (TIGTA)

Some of the most important rights that are relevant to our plan are:

Issue Resolution Process. No taxpayer should ever be presented with a notice asserting a deficiency in tax without a prompt opportunity to communicate with a qualified IRS employee who can explain the basis for the asserted deficiency and how it can be resolved. This is the intent of all the Shrink the Tax Gap proposals and is implicit in the service goals we propose. This commitment could be further clarified by law or regulation.

Appeal Rights. Right of appeal of an asserted deficiency to the IRS independent Appeals Office (recently strengthened by the Taxpayer First Act).

Burden of Proof on Assessments. Although courts have held that the IRS has the burden of proof in making a deficiency assessment based solely on third-party reporting, this rule should be mandated for internal IRS practice. To ensure implementation of this right, the IRS should provide taxpayers a process for identifying errors on information return

Recovery of Attorney's Fees. Clarify Eligibility for Small Business Taxpayers to Recover Attorney's Fee and increase limits on fees.

Access to Tax Court Assure that taxpayer have access to tax court before paying assessments by allowing tax court power to accept jurisdiction on equitable grounds, and include cases of penalties assessed by the IRS in the tax court jurisdiction.

Self-employed Access to VITA sites. Expand the jurisdiction of federal funded VITA sites to assist self-employed individuals.

Operations and Financial Metrics

In addition to the items discussed above, the IRS produces many operational statistics and much budget and financial data. This includes data reported internally to manage the agency, to support budget requests and to report periodically to Treasury, OMB and Congress. This data includes project level data on specific modernization projects and other initiatives and would be readily expanded to cover all the STTG programs.

External Indications of Progress

In a recent CBO report on IRS enforcement, CBO suggested an excellent possibility for considering the impact of major IRS programs, stating the following:

"The scorekeeping guidelines do not apply to CBO's baseline budget projections or to its other projections such as the analysis of the President's budget. So, although CBO does not include the revenue effects of changes in the IRS's funding in cost estimates, the agency incorporates both the spending and revenue effects of enacted legislation in its next update of baseline budget projections."[13]

For a program like STTG, which would over time have a material impact on revenue estimates, CBO's ability to incorporate this impact in its regular revenue and budget projections would be extremely valuable. Although it would not necessarily tie precisely to the impact of STTG, it would show revenue trends over time as the program progressed.

Oversight

In a major program such as we recommend, it would be essential for the incumbent administration and Congressional Committees to conduct regular oversight. Establishing clear goals and a set of regularly reported milestones and metrics as recommended in this paper would provide a baseline for these oversight committees to evaluate progress and make recommendations for changes. The GAO and TIGTA, well established independent reviewers of IRS activities, could use this baseline and these regularly provided metrics, as well as their own audits, to inform the oversight committees.

[13] Congressional Budget Office (CBO), *Trends in Internal Revenue Service's Funding and Enforcement*. July 2020.

This approach would ensure that resources were used as intended, that plans were adjusted based on experience, and that the public could be informed of progress.

Legislative Financial Analysis Summary

March 14, 2021

Basis for cost estimates

The Shrink the Tax Gap proposal is for a major long-term program aimed at reducing major sources of underreported income.

We have done considerable analysis to document a plan that includes additional information reporting, a major technology program to make full use of all the information available to the IRS, and a scaled up and modernized matching and auditing program.

We have estimated in some detail the technology costs and the staffing and support costs to fund this program over a ten-year period. This estimate is fully explained in documents and spreadsheets on our web site shrinkthetaxgap.com. The details of the methodology for estimating technology costs, staffing costs and overall summary costs are explained in Appendices B, C and D and the calculations are shown in Exhibits 9, 10 and 11.

These estimates necessarily used certain conventions. One of these conventions is the assumption that the program began on January 1, 2020. We also assumed that all other programs, including modernization of legacy systems, not in scope for the STTG program, would be rolled forward with only an inflationary annual adjustment, assumed to be 2% per year.

Adjusting to fit a Legislative Timetable for funding

We adjusted our STTG cost estimates to fit an assumed legislative timetable as follows:

- Authorizing legislation passed in calendar 2021
- IRS Planning phase started in fiscal 2022
- IRS STTG program starts in fiscal 2023

The results for the adjusted program are shown in the Exhibit 16, STTG Legislation Financial Analysis along with the assumption used to make the adjustments. The ten-year total costs are as follows:

STTG Technology w/Inflation Shifted	$13,373,000
STTG Staffing w/Inflation Shifted	$59,253,000
Organizing & Planning	$29,000
Total STTG Funding Request	$73,005,000

Also shown is a summary functional allocation of total projected ten-year costs, which is as follows:

Summary Allocation of Total STTG Ten Year Costs		
		% of total
Technology Investment		19%
Staffing and support		
	Enforcement	62%
	Pre-filing education and service	6%
	Appeals, Counsel, Taxpayer Advocate	14%
Total for Shriink the Tax Gap Program		100%

What is Included and Not Included in STTG Program Costs Estimates

The STTG program cost estimates include all costs necessary to develop and implement the STTG program over a ten-year period. This includes technology development and operating costs for all new technology needed to support the STTG program, as well as an allocation for necessary modifications to IRS legacy systems. It also includes staffing costs, for the modernized enforcement program, which consists of:

- Field exams; e-exams, and enhanced matching
- Staffing costs for pre-filing and customer service related to the STTG information reporting and enforcement programs
- Staffing for the post enforcement processes of appeals, Counsel and the Taxpayer Advocate and responding to taxpayer and adviser inquiries, and
- An allowance for support costs related to the direct staffing costs.

The STTG cost estimates do not include any incremental costs needed for the IRS to provide industry standard customer service in its day-to-day dealings with the vast majority of compliant taxpayers and their advisors. It also does not include costs required for ongoing modernization of IRS legacy systems beyond what is in the IRS base budget, or for supporting newly enacted programs such as the periodic child credit. Funding for some of these items may be included in recently enacted IRS appropriations. In our estimates, we only assumed a constant IRS base budget increased 2% per year for inflation.

Four points worth emphasizing:

1. This kind of change cannot happen over-night; the 10-year funding period is needed to permit effective implementation.
2. In turn, this will require long-term funding commitments and consistency in much needed Congressional and Executive Branch oversight.
3. The primary driver of shrinking the tax gap will be the improved voluntary compliance from enhanced information reporting, supported by modernized technology and enforcement. Approximately 68% of our estimate of the revenue gain is from enhanced voluntary compliance.

4. While not covered by the STTG cost estimates, meeting industry standard service levels for basic tax law and account inquiries is an essential element of improving compliance.

Legislative Financial Analysis Detail

Adjusting the Original Shrink the Tax Gap Proposal the Fit a Revised Legislative Timeline

This spreadsheet presents our best estimate of costs of implementing our Shirnk the Tax Gap Program, including IRS technology investment and IRS staffing increment.
It assumes that legislation authorizing the program would become effective in calendar 2021 and the IRS would implement a small planning phase in FY22, with the principal program beginning in FY 2023
(see notes below for calculation methodology)

Original Data

		CY2020	CY2021	CY2022	CY2023	CY2024	CY2025	CY2026	CY2027	CY2028	CY2029					Total
Base Budget		12,630	12,883	13,140	13,403	13,671	13,945	14,223	14,508	14,798	15,094					138,295
STTG Technology Investment		64	388	502	657	949	1,289	1,724	1,950	2,153	2,341					12,017
STTG Staffing Increment		641	1,412	2,256	3,350	4,430	5,649	7,150	8,154	9,382	9,382					51,806
Total STTG		705	1,800	2,758	4,007	5,379	6,938	8,874	10,104	11,535	11,723					63,823

Original Shifted 3 Years (except IRS Base Budget)

					CY2023	CY2024	CY2025	CY2026	CY2027	CY2028	CY2029	CY2030	CY2031	CY2032		Total
Base Budget					13,403	13,671	13,945	14,223	14,508	14,798	15,094	15,396	15,704	16,018		146,760
STTG Technology Investment					64	388	502	657	949	1,289	1,724	1,950	2,153	2,341		12,017
STTG Staffing Increment					641	1,412	2,256	3,350	4,430	5,649	7,150	8,154	9,382	9,382		51,806
Total STTG					705	1,800	2,758	4,007	5,379	6,938	8,874	10,104	11,535	11,723		63,823
Inflation Factor	0.02		1.020	1.040	1.061	1.082	1.104	1.126	1.149	1.172	1.195	1.219	1.243	1.268		
STTG Technology w/Inflation					68	420	554	740	1,090	1,510	2,060	2,377	2,677	2,969		14,466
STTG Staffing w/Inflation					680	1,528	2,491	3,773	5,089	6,619	8,545	9,940	11,665	11,899		62,228
Total STTG w/Inflation					748	1,948	3,045	4,513	6,179	8,129	10,605	12,317	14,342	14,868		76,694

Shift to FY, Add Planning

				FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032		Total
STTG Technology w/Inflation Shifted					51	332	521	693	1,003	1,405	1,923	2,298	2,602	2,896		13,723
STTG Staffing w/Inflation Shifted					510	1,316	2,250	3,452	4,760	6,236	8,063	9,591	11,234	11,840		59,253
Organizing & Planning				17	11											29
Total STTG Funding Request				17	572	1,648	2,771	4,146	5,762	7,641	9,986	11,889	13,836	14,736	0	73,005

Calculation Methodology

1. Started with figures from the Sept. 14 Tax Notes article, which were on a calendar year (CY) basis, starting in 2020, with a 6-month planning workstream
2. Moved that to a CY2023 start, incorporating a 2% inflation escalation to expenses; IRS base budget was kept and extended with a 2% annual increase
3. Shifted to a fiscal year (FY) basis for STTG Program costs and added an additional Organizing and Planning task to preceed STTG Program start

Revenue Estimating Methodology

Calculating the Revenue Impact, Revision 2

April 7, 2021

Note: All STTG articles, appendices and exhibits referenced in this Exhibit A, Revision 2, are posted on our website www.shrinkthetaxgap.com.

Introduction

This Appendix represents our second revision of the document first published in connection with our *Tax Notes* article on March 2, 2020. The basic methodology is the same, but we made two significant changes. We revised the projected revenue phase-in to be consistent with the more detailed timeline described in Appendix B, in connection with our second *Tax Notes* article published on September 11, 2020. We then further revised the revenue estimate to be consistent with our updated plan for information reporting (see Update 1 on our website). Our revised information reporting plan limits the 1099NEW to taxpayers with low visibility income in the top income quartile and related passthrough businesses. This change reduced our overall estimate of the revenue gain over 10 years from about $1.6 trillion to about $1.4 trillion.

We estimated the revenue gain from implementing the plan using published IRS data and compliance studies. In addition, we used IRS data and other government data to project revenue estimates over a 10-year budget window for the years 2020 through 2029.

This Appendix documents the methodology and the resulting calculations. Each exhibit notes the specific source of the data used in the calculations.

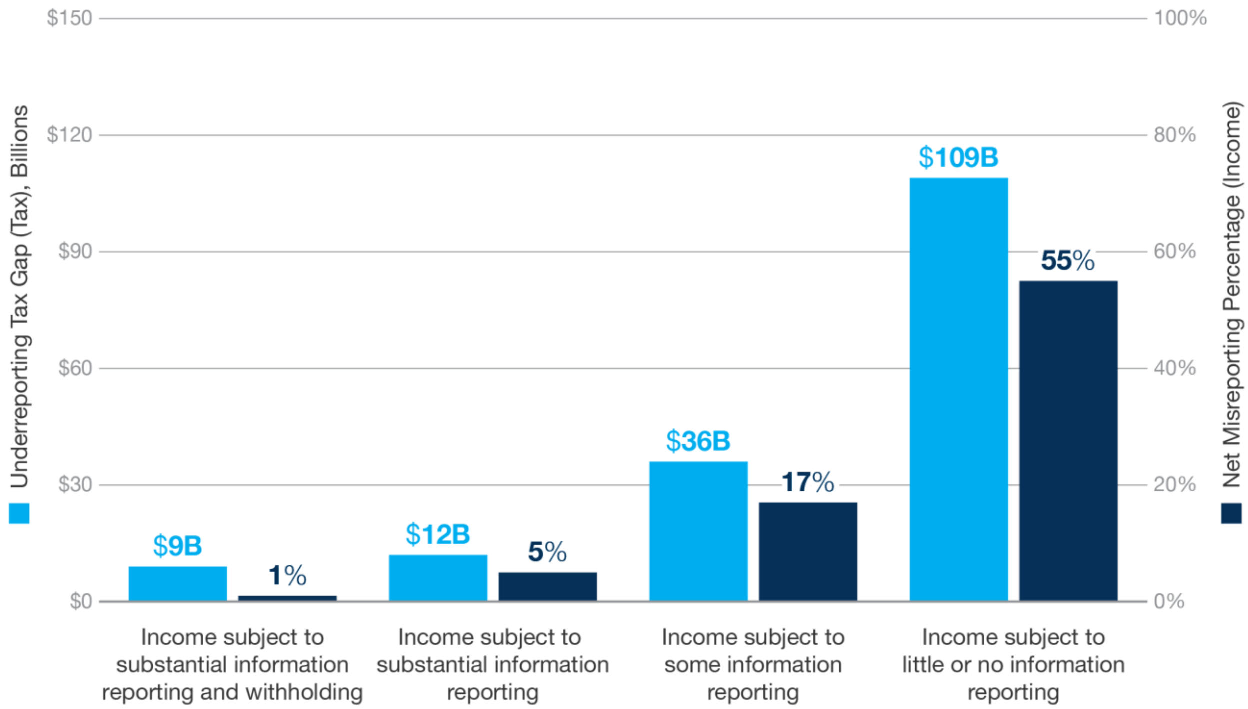
As the author, I am responsible for the estimates. I was ably assisted in these calculations by Michael Udell of the District Economics Group and by other highly qualified experts in tax and advanced technology.

Methodology Summary

It is well established by many IRS studies that the fraction of underreported income is driven by the visibility of the income source as determined by the level of third-party reporting that the IRS can use to follow up. This chart, from the IRS Research, Applied Analytics & Statistics study titled *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013*, shows this difference clearly.

“Visibility” Chart

Tax Year 2011–2013 Individual Income Tax Underreporting Tax Gap and Net Misreporting Percentage Estimates By “Visibility” Category of Income Items



We made our revenue estimates by calculating how much revenue would be gained if income in the two lowest visibility categories were each improved by one level. The misreporting percentage of income in the lowest category would improve from 55 percent to 17 percent, and the second lowest category would improve from 17 percent to 5 percent.

We made separate calculations for income reported on individual returns and passthrough returns.

We did a detailed estimate of the revenue impact of our plan for one tax year if the improvement had all occurred in that year. We then assumed that this improvement would take a full 10 years to achieve, and we estimated a phase-in over the 10-year period. We applied standard revenue projecting factors to estimate the impact for each year of the 10-year budget period from 2020 through 2029.

Our end result is summarized in Exhibit 1, Projection of Gains from STTG.

Two items are very critical to note about this methodology. One, the revenue gain is the result of a **combined 3-part program** of increased information reporting; improved technology to make use of all the pertinent information (including not only our proposed 1099NEW but more use of existing information) and finally efficient follow-up on identified deficiencies in returns. This is the process that works today that allows the IRS to efficiently collect 95 to 99 percent of the taxes due in the two highest visibility categories. We are proposing to extend that approach to more sources of income[14]. And, two, even after our projected 10-year period, **our estimated gain is still only a cumulative 19 percent of the tax gap over that period.** This is true because we are only assuming a relative, not a full, improvement in underreported income, and even that improvement occurs gradually over the period.

The sections below discuss the methodology for each aspect of the calculations, followed by a discussion of the 10-year projections. Each section refers to exhibits which contain spreadsheets and backup data. The list of relevant exhibits, which can be found at www.shrinkthetaxgap.com, is as follows:

1. Projection of Gains from STTG
2. Tax Gap Projection to 2019
3. Tax Gap: Calculation of Gain from Individuals
4. Tax Gap: Calculation of Gain from Mid-sized Passthroughs

Reduction in Tax Gap from Additional Third-Party Reporting, Taxpayer Reconciliation Schedule and Modernized Compliance Process and Technology

Individuals with Unreported Income

The STTG plan describes reforms for individuals with income that is not currently reported by third parties. The reforms include increased reporting by banks of deposits and disbursements in the bank accounts used by taxpayers for their business activities, a schedule attached to the taxpayer's return to reconcile the bank reporting with the tax return and a modernized technology-supported compliance program to make use of all available data.

See Exhibit 3 for details of calculations used for the STTG plan.

We based our estimates of the revenue gains under this plan on the most recent IRS Research, Applied Analytics & Statistics study titled *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013*.

Taking into account the amounts that IRS existing enforcement activities already collect, and eliminating any gain from income taxpayers below the top quartile of the income distribution, the net gain from these proposed STTG reforms in the 2011 through 2013 period of the IRS study would have been $57.3 billion if the plan were fully effective in that year.

This is equivalent to $78.7 billion for fiscal year 2019.

The IRS study showed $109 billion of tax lost from individual returns with underreported income of the type that has "little or no information reporting." An additional $15 billion is lost from related self-employment income, for a total of $124 billion. (The IRS study identified a total of $45 billion of tax

[14] The sources of income to which we are increasing the visibility, which are various forms of business income, are more complex than most other sources, which is why we also recommend a supplementary reconciliation schedule that taxpayers can use to explain differences between the information report and their return without the need for IRS follow up.

loss from self-employment income, but we only included a proportion that we could relate directly to the underreported business income.) For this category of income, 55 percent of the income that should have been reported was not reported.

The same IRS study showed that the categories of income that had “some information reporting” had only 17 percent underreporting.

We estimate that the STTG plan will move the $124 billion category of underreported income to the “some information reporting” category. With additional reporting and IRS follow up, this move to the “some information reporting” category would reduce the underreporting percentage from 55 percent to 17 percent.

In addition, using a similar approach, $36 billion of underreported income identified in the IRS study would be moved from the “some information reporting” category to the “substantial reporting” category, thereby reducing the underreporting percentage from 17 percent to five percent.

As shown in Exhibit 3, these numbers from the IRS study were adjusted downward to account for the STTG plan is to provide the new information reporting only for the top quartile of individual taxpayers.

A modernization of the IRS compliance program, making use of modern advanced analytical models to use additional data recommended by the STTG plan, would be an essential aspect of realizing the potential revenue that could be generated. This is explained in more detail in the section of the STTG main plan titled “How the modernized compliance and assistance program would work.in our Tax Notes article published on September 11, 2020.”

In extrapolating from a one-year gain to an actual gain over 10 years, we have assumed a conservative curve that converges over 10 years. We assume we do not reach the target level until the final year. This estimate is discussed below in the section on projections.

Mid-sized Passthroughs: S Corporations and Partnerships

We did not include any estimate of revenue gains from passthroughs with over $25 million receipts because we assume large passthroughs are mostly technically compliant We believe all IRS compliance tools would be used to find non-compliance in these large passthroughs, but we did not have a basis for estimating revenue from this source. We view this as a very conservative assumption in our estimates. A recent study by National Bureau of Economic Research, released after our calculations were completed, estimates that tax evasion in the top one percent of the income distribution was much greater than previously estimated, much of it through use of partnerships.[15]

STTG proposes reforms for the compliance program for mid-sized passthrough businesses that are similar to that for individuals with business income.

This includes increased reporting by banks of deposits and expenditures in the bank accounts used by taxpayers for their business activities, a schedule provided to the IRS to reconcile the bank reporting with the tax return and a modernized compliance program supported by advanced technology together with some focused field audits. Only passthroughs with ownership interest by

[15] National Bureau of Economic Research: Guyton, Langetieg, Reck, Reish, & Zucman (March 2021). “Tax Evasion at the Top of the Income Distribution: Theory and Evidence.” Working Paper 28542. Cambridge, MA.

top quartile taxpayers would receive the 1099NEW, but we estimate that as much as 97 percent of all passthrough income is received by the top quartile taxpayers.

See Exhibit 4 for details of the calculations for this calculation.

We estimated the revenue gain from this plan based on the only available IRS compliance study of S corporations and the most recent IRS Research, Applied Analytics & Statistics tax gap study, titled *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013*.

The IRS tax gap study provided data on the amount of underreported tax (NMA) and the percentage of underreported tax (NMP) by visibility category. Business income of sole proprietors fell into the lowest visibility category with an NMP of 55 percent.

The IRS study of S corporations found that those with under $200,000 receipts (2004 dollars) were comparable to small proprietors, while those over that level had an NMP that was half that amount. The conclusions of this study are completely consistent with the factors that generally drive compliance—lack of meaningful third-party reporting and negligible audit activity (on the order on tenth of one percent for passthroughs)

Using these statistics, and SOI tax year 2016 data on the income of the mid-sized passthroughs, we calculated the net gain in tax in the same manner as described above for individuals with underreported income.

We then adjusted the gain for the amount that would be collected through existing enforcement.

For all unreported income, enforced and late payments are 14 percent of the gap. In the case of these entities, there's negligible direct enforcement, but assuming that some unreported income is detected in audits of individuals, we assumed that half of this general ratio is collected.

These calculations result in a net gain in tax year 2016 of $52 billion, if the plan were fully effective in that year. This is equivalent to $64 billion in 2019 dollars. This estimate was not materially affected by the change in our plan to limit the 1099NEW to the top quartile of taxpayers because such a large fraction of passthrough income in earned by top quartile taxpayers.

We assume that the phase-up curve of compliance would be the same as discussed above for individuals with business income. This phase-in methodology is discussed further in the section on projections.

Projection Methodology

As discussed above, the revenue gain from proposed reforms under STTG was estimated for a baseline year using IRS compliance studies. We applied the same methodology for the tax gap plan for individuals and medium-sized passthroughs. This baseline year analysis shows what the revenue gain would have been for that year if the plan had been fully effective. These baseline calculations are detailed in Exhibits 3 and 4.

We first projected forward the estimated annual tax gain from the base years using CBO's projection of total federal tax receipts. We used this index because the tax gap itself is a calculation of the shortfall in receipts from taxes that are due but not paid. The tax gap ratio to total receipts has been reasonably steady over the last several compliance studies. This estimate was projected forward for each year in the 10-year period 2020 through 2029, since we were using a convention that the reforms were passed into law in 2019 and made effective as of January 1, 2020. These projections are shown in Exhibit 1, including the backup indices used to make the projections. This calculation shows what the revenue gain would be for each year in the period if it were fully effective in that year.

Since we assumed the proposed plan would not be fully effective until the tenth year (2029), we then backed down the revenue estimates each year to allow for the phase in the plan and the likely taxpayer response during the period.

At the end of the 10-year period, nearly the full projected tax gain is achieved.

This assumption does NOT imply 100 percent compliance in reported income. It only implies that misreporting will be reduced to the misreporting percentage associated with the next higher level of visibility of income. For example, misreporting by individuals with income in the lowest visibility category, which is 55 percent, would drop to 17 percent misreporting associated with the next visibility category. In other words, in this example, even after 10 years of increased reporting and enhanced 100 percent technology processing of returns, it assumes that the tax on 17 percent of the business income still would not be reported. This level of underreporting is more than three times the level of misreporting for income such as dividends and interest that receive 1099 reports (which is five percent).[16]

In addition, the IRS data that shows reporting compliance at each visibility level is voluntary compliance, before adding whatever IRS gets from enforcement through examination and matching. In other words, for the “some reporting” visibility category, the voluntary compliance is 83 percent (100 minus 17). The additional income that the IRS recovers from enforcement is on the average about 3 percent of the unreported income, thus over 99 percent of the income that is reported in this visibility category is from voluntary compliance as compared with enforcement.[17] In our estimates we counted maximum total compliance in the final year of the plan, including both voluntary and auditing, at the 83 percent level. However, we assumed a much more conservative estimate of what

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[16] Internal Revenue Service (IRS) Research, Applied Analytics & Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013*, Publication 1415 (Rev. 9-2019), Washington, DC. “These most recent estimates continue to confirm the relationship between reporting compliance and third-party information reporting that was demonstrated by prior tax gap estimates. For the individual income tax, reporting compliance is far higher when income items are subject to information reporting and even higher when also subject to withholding. As shown in Figure 3 on page 14, from the individual income tax underreporting tax gap estimates, the net misreporting percentage (NMP) for income amounts subject to substantial information reporting and withholding is one percent; for income amounts subject to substantial information reporting but not withholding, the NMP is five percent; and for income amounts subject to little or no information reporting, such as nonfarm proprietor income, the NMP is 55 percent. The grouping of items into categories is the same as for the TY 2008–2010 estimates.”

[17]

Visibility category 3 with "some information reporting"		
	Net misreporting percentage	17%
	Voluntary reporting percentage	83%
	Average % of gap recovered by exam and AUR	3%
Percent	Amount recovered by auditing and AUR	0.5%
	Total reported after enforcement	83.5%
	Percent reported by voluntary compliance	99%

fraction of that revenue would come from voluntary compliance versus enforcement. Our final year estimates are that only 58 percent of the revenue would come from voluntary compliance and the rest from some form of enforcement. Much of this enforcement we propose would be much more data driven, more focused and more efficient than traditional audits, but we considered any follow-up with taxpayers to fall under the heading of “enforcement.” Our proposed follow-up enforcement process is discussed in detail in our September 11, 2020 *Tax Notes* article and in Appendix B.

We made this more conservative assumption about the ratio between voluntary compliance and enforcement because the sources of income in the lowest visibility category have been historically much more non-compliant and more difficult to recover. To the extent that voluntary compliance in this category increased to more historical levels, the amount of required enforcement would decrease.

In our enforcement estimates we did not specifically allow for collection enforcement on underreported taxes assessed but not paid. Since 100 percent of our estimated revenue is from upper income taxpayers the amount of collection enforcement should be small relative to the underreporting component. Some additional collection resources would likely be required but we believe our estimate of enforcement is sufficiently large to provide for them.

Our final calculation was to estimate the time phasing of the increase in estimated revenue over the 10-year time period. This phase-up is also shown in Exhibit 1, broken down between voluntary compliance and enforcement by year. This estimate is judgmental but is based on both the factors affecting taxpayer behavior and the specific milestones in the STTG plan.

Factors Affecting Taxpayer Behavior

Initiation of third-party reporting for business income and the requirement for preparing a reconciliation schedule would produce an initial voluntary increase in compliance. This would occur for three reasons:

- Taxpayers would have a new document which would provide specific information on what to report and would serve as a reminder to do so,
- Tax preparers would be on notice that the IRS has verifiable information, and
- The risk of non-compliance would obviously increase, especially if this risk is effectively communicated by the IRS.

In addition, it would be important for the IRS to increase some field auditing based on this new information, even while upgraded technology was being implemented. This auditing would produce immediate revenue, show taxpayers that the additional reporting was being used and, very importantly, produce valuable data to inform the machine learning models.

These considerations would lead to a partial but immediate increase in compliance in the first years after the increased reporting occurred.

On the other hand, some taxpayers would ignore the requirement but would eventually comply once the IRS notified them of deficiencies in their returns and followed up appropriately. This increase in compliance would build up gradually over time, driven in part by the build-up in the IRS of enhanced compliance programs, which we refer to as enhanced matching, E-exams and field exams. As described in more detail in our September 11 Tax Notes article and in Appendix B on our recommended technology program, each of these compliance programs would be data driven using machine learning technology to initiate the process.

Some taxpayers would actively resist compliance and require aggressive enforcement to produce eventual compliance, including in a few cases potential criminal prosecution where outright fraudulent behavior has occurred.

Assuming the IRS over a ten-year period implements the improved technology and enhanced compliance programs recommended by the STTG plan, compliance would converge to a level close to that which already exists in the categories of income where substantial third-party reporting exists, which is what our estimate assumes. This conclusion is clear from the long-term data on the level of compliance where third-party reporting has been in effect for a long time.

STTG Plan Milestones

The timeline for the start-up of the plan is based on the following key milestones (discussed more fully in our Plan Update 1 and Appendix B):

- ***Authorizing legislation passed***, allowing plan to begin after startup and planning period.
- ***First full year of STTG***. IRS issues guidance and education materials to taxpayers and preparers, describing the plans for the 1099NEW information report and reconciliation schedule. IRS provides restricted access to financial institutions to determine which taxpayers will receive the 1099NEW.
- ***Second full year of STTG***. Taxpayers receive first 1099NEW. IRS provides additional detail and educational materials to taxpayers and preparers concerning the 1099NEW and the optional reconciliation schedule. Taxpayers file returns using 1099NEW with optional reconciliation schedule. IRS initiates traditional examinations of returns using 1099NEW and other existing data, and begins to build models.
- ***Third full year of STTG***. Taxpayers receive second year of 1099NEW, and those over $400,000 income and passthrough entities are required to file reconciliation schedule. IRS expands traditional examinations and expands models.

Beginning in the second year, a modest amount of enforced compliance will occur, and then will increase as the IRS builds its enhanced technology-enabled compliance program. Compliance gains will then level off and only increase gradually as more enforcement cases will occur.

As shown in Exhibit 1 we estimated a voluntary compliance ratio and enforced compliance ratio for each year. The voluntary compliance ratio is the fraction of the full gain that would be achieved in that year from voluntary compliance and the enforced compliance ratio is the fraction of the full gain that would be achieved through all forms of enforcement activity.

Our assumption is that the voluntary compliance ratio will start at 20 percent, which means that 20 percent of the difference between the lower visibility category and the next lowest would be reported.

History shows that when additional specific supporting documentation is required from taxpayers, compliance increases. See Exhibit 5 for the immediate effect of additional reporting in the Tax Reform Act of 1986.

Some revenue will be received in the first full year of the plan because taxpayers with business income must file quarterly estimates and are subject to penalties for underpayment.

Overall, during the 10-year period the STTG plan would steadily shrink the tax gap as compared to its current unmitigated trajectory. By 2029, it would reduce the gap by approximately $242 billion, a 26 percent reduction. Over the 10-year period, it would reduce the tax by a cumulative 19 percent.

While we have not estimated what would happen after the first 10-year period, we believe the gradual progress in shrinking the gap would continue. Even after the projected gains in the first 10-year period, 74 percent of the tax gap would remain to be addressed. Some staff resources could be reassigned from cases with business returns to non-business returns and non-filing cases. The nature of the process proposed by STTG is one of continuous improvement, using data gathered to improve the models and the process. This would enable increasingly precise assessments of non-compliance in specific returns and increasing efficient communications with taxpayers.

Adjusting to Different Start Years

Using these conventions, the estimates in this report could readily be revised for an assumption about any later start year.

Any multi-year projection is subject to error because of variations in the forecast of underlying macroeconomic variables, such as GDP and total tax receipts. We used the latest Congressional Budget Office (CBO) projections for these variables and therefore our projections contain the same level of likely variations as the CBO projections, which are also used to project tax revenue in the existing tax system. On a relative basis, we do not know of any reason that the revenue results under our plan would vary more or less than those the CBO makes for the current tax system.

Revenue Estimating Detail

Exhibit 1: Projection of Gains from STTG (formerly referred to as TCAM)

Estimated Revenue Gain from STTG over Ten Years including comparative statistics

Exhibit 1 **8-Apr-21**

This sheet estimates the revenue gain from the STTG proposals over a ten year period
The etimate assumes that the proposals were passed in calendar 2019 and became effective
for tax years beginning January 1, 2(The phase in methodology is explained in Appendix A
see data sources tab for data sources
is revision adjusts the phase-in of the revenue gain to correspond with the timeline in Appendix
and update 1 limiting information reporiing to top quartile individuals and related passthrough businesses
dollars in billions

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	Cumulative 20-29		
Tax Gap Proposals																				
Individuals with AGI in top quartile and low visibility income																				
One Year full Gain net of existing enforcement Exhibit 3	57.3																			
Index: CBO total receipts base =2011-2013 average	1	1.203905	1.294766	1.30234	1.32147	1.32625	1.3752872	1.4425724	1.5112671	1.5824131	1.6589956	1.7500844	1.8270283	1.95274376	2.07452032	2.1477868	2.2393928			
Future Year full Gain before Adjustments	57.3	69.0	74.2	74.6	75.7	76.0	78.8	82.7	86.6	90.7	95.1	100.3	104.7	111.9	118.9	123.1	128.3	1,042.10		
Voluntary response ratio (see appendix)								20%	35%	43%	48%	50%	51%	52%	54%	56%	58%			
Enforced response ratio (see appendix)								0%	5%	10%	15%	20%	25%	30%	35%	38%	41%			
Phase in shortfall ratio (1- total response)								80%	60%	47%	37%	30%	24%	18%	11%	6%	1%			
Shortfall amount due to phase in	57.3	69.0	74.2	74.6	75.7	76.0	78.8	66.1	52.0	42.6	35.2	30.1	25.1	20.1	13.1	7.4	1.3	292.97		
Net Gain after phase in	0.0	0.0	0.0	0.0	0.0	0.0	0.0	16.5	34.6	48.1	59.9	70.2	79.6	91.8	105.8	115.7	127.0	749.14		
Medium -sized passthroughs, under $25 million receipts with ownership by top quartile individuals																				
One Year full Gain net of existing enforcement Exhibit 4	52.2																			
Index: CBO total receipts base =2011-2013 average	1	1.203905	1.294766	1.30234	1.32147	1.32625	1.3752872	1.4425724	1.5112671	1.5824131	1.6589956	1.7500844	1.8270283	1.95274376	2.07452032	2.1477868	2.2393928			
Future Year full Gain before Adjustments	52.2	62.8	67.6	68.0	69.0	69.2	71.8	75.3	78.9	82.6	86.6	91.3	95.3	101.9	108.2	112.1	116.8			
Voluntary response ratio (see appendix)								20%	35%	43%	48%	50%	51%	52%	54%	56%	58%			
Enforced response ratio (see appendix)								0%	3%	7%	11%	17%	22%	26%	32%	36%	41%			
Phase in shortfall ratio (1- total response)								80%	62%	50%	41%	33%	27%	22%	14%	8%	1%			
Shortfall amount due to phase in								60.2	48.9	41.3	35.5	30.1	25.7	22.4	15.2	9.0	1.2	289.46		
Net Gain after phase in								15.1	30.0	41.3	51.1	61.2	69.6	79.5	93.1	103.1	115.7	659.50		
Total STTG Tax Gap Gain								31.6	64.6	89.3	111.0	131.4	149.2	171.2	198.9	218.8	242.7	1,408.64		105%
Tax Gap if ratios unchanged (Unmitigated tax ga	See Exhibit 2 for calcuation of tax gap in 2019						574.2	602.3	631.0	660.7	692.7	730.7	762.8	815.3	866.1	896.7	935.0	7,593.22		
Gain as % of tax gap								**5%**	**10%**	**14%**	**16%**	**18%**	**20%**	**21%**	**23%**	**24%**	**26%**	**19%**		
Total STTG Tax Gap Gain								31.59	64.60	89.34	110.96	131.38	149.16	171.23	198.89	218.79	242.71	1,408.64		
IRS Budget Increment								0.71	1.71	2.66	3.91	5.26	6.79	8.70	9.94	11.36	11.54	**62.60**		
Grand Total Gain Net of IRS Budget Increment								**30.9**	**62.9**	**86.7**	**107.0**	**126.1**	**142.4**	**162.5**	**188.9**	**207.4**	**231.2**	1,346.03		
CBO Estimate of Receipts								3620	3792	3971	4163	4392	4585	4900	5206	5390	5619	45,636.76		
% increase in Receipts								0.9%	1.7%	2.2%	2.6%	2.9%	3.1%	3.3%	3.6%	3.8%	4.1%	2.9%		
CBO Estimate of GDP								22231	23083	23946	24836	25769	26765	27775	28860	29981	31141	#########		
Receipts as % of GDP								16.3%	16.4%	16.6%	16.8%	17.0%	17.1%	17.6%	18.0%	18.0%	18.0%	17.3%		
Receipts Increment as % of GDP								0.1%	0.3%	0.4%	0.4%	0.5%	0.5%	0.6%	0.7%	0.7%	0.7%	0.5%		
CBO Receipts plus STTG increment as % of GDP								16.4%	16.7%	17.0%	17.2%	17.6%	17.7%	18.3%	18.7%	18.7%	18.8%	17.8%		
ratio of revenue gain to IRS increment								45	38	34	28	25	22	20	20	19	21	23		
Individual Income tax paid by bottom 90%; see indices tab								550	578	605	634	663	694	764	834	866	904	7,091.33		
Ratio of Revenue Gain to Tax paid by bottom 90%								6%	11%	15%	18%	20%	22%	22%	24%	25%	27%			

Exhibit 3: Tax Gap, Calculation of Gain from Individuals

Exhibit 3 -1 Tax Gap Calculation of gain from underreported income of individuals in top quartile of AGI

Calculation of tax gain related to proposal for additional third party reporting of individual income
with reconciliation schedule and advanced technology

This sheet estimates the tax gain that could be obtained by improved external reporting of income reported
by individuals. It is based on the IRS compliance study of returns in tax years 2011-2013 which
includes data showing how misreporting varies depending on the degree of external reporting
Specifically , this sheet calculates the gain if the tax lost on income that is now subject to" little or no reporting"
were reduced to the level of income that is now subject to "some reporting"
It also applies this reduction to self-employement tax that is related to the misreported income Finally a reduction
a reduction in the next lower tier of amount with" some reporting "is reduced to the level with "substantial reporting"
Finally, the amounts are extrapolated to future years based on CBO estimatess of total revenue
The gain is adjusted to account for tax that would be collected by existing enforcement and for
the exemption from reporting of taxpayers with agi of at least 84,000 in ty 2018 top 25% of taxayers

IRS summary tax gap data from 2011-2013 study	2011-2013 study
tax paid voluntarily and timely	2242
tax eventually paid	2302
gross tax gap	441
enforced and late payments	60
net tax gap	381
enforced and late as percent of underreporting gross gap	14%
Underreporting gap	352
self employment gap	45

gap by visibilty tier	NMP	NMA
individual income tax gap with little or no reporting	0.55	109
self employement tax gap related to above(see calculation belo		25.0
Fraction of income over 84923(top 25%)	49.4%	53.9
self employement tax related to above		12.3
gap with some reporting	0.17	36
NMP with substantial reporting	0.05	

calculation of additional tax by visibility categroy if NMP is improved to next tier
See lines below for derivaion of formula

		2011-2013 study	
		no=.55	some=.17
		nma	tax gained
low visibility business income		53.9	**37.23204**
related SE tax		12.3	**8.524284**
		66.2	45.75632
next visibility tier income		0.17	0.05
		36	**25.41176**
Total tax gain			71.16809
enforced and late payments under existing method (applied to nma)	14%		13.90833
Net gain after tax that would be collected under existing methods			57.25975
net gain after exemption			**57.25975**
brought forward to 2019 factor based on receipts	1.375287194		**78.74861**

derivation of formula for tax gain from increased reporting

	2011-2013 study	alternative calculation if NMP is half (.275) 2011-13 study
Net Misreported Amount	109	54.5
Net Misreported %	0.55	0.275
Amount that should have been reported nma/nmp	198.1818	198.1818
Amount reported	89.18182	143.6818
NMP with higher visibility	0.17	0.17
NMA with higher visibility	33.69091	33.69091
gain	75.30909	20.80909
% of NMA gained	69%	38%
equivalent to (NMPH-NMPL)/NMRPH	69%	38%
gain as percent of actual reported	84%	
% of NMA reported for some reporting categry move from 17% NMP to 5% NMP	71%	

Income distribution of sole proprietors by repoted net income used to calculate SE tax and exemption amount

SOI Data for tax year 2016 distribution of net income of sole proprietorships				number of returns		
total	328.2	total positive	350.1	25.5		
<2500	-20.5	cumulative positive		6.2	24.3%	
2500-5000	-1.4			2.7	34.9%	Calculatiions of SE limits
5000-1000	7.1		2.0%	3.5	48.6%	
1000-25000	41.2		13.8%	5.4	69.8%	% over se limit
25000-50000	43.2		26.1%	3.1	82.0%	assuming midpoint
50000-100000	59.1		43.0%	2.2	90.6%	of bracket
100000-200000	57.4		59.4%	1.3	95.7%	51%
200000-500000	67.6		78.7%	0.8	98.8%	% under se limit and
500000-1000000	34.2		88.5%	0.3	100.0%	ove exemption
1000000-2500000	23.5		95.2%	0.1	100.4%	25%
2500000-500000	8.2		97.5%	0.025	100.5%	
>5000000	8.8		100.1%	0.011	100.5%	Weighting of % under se limit
						33%

Calculation of self employment tax retated to unreported business income

Effective SE rate on income under 132900	asssumes top tax bracket of 37%		
11.5%			this adjusts for part of se tax that is deductible
Effective SE reate on income above 132900		2.9%	this is the part of the tax that is uncapped
weigthed average	5.7%		this weights the rates for the fraction that is over the cap
Convert to percent of NMA			
Asssume 25% average tax bracket for NMA		0.25	
SE tax as % of NMA		22.9%	this converts the se tax to a percentage of the nma
			this fraction is carried to H29

Note this calculation of related self employment tax is slighty understated because the Update 1 to the information reporting
proposal did not include an exemption but did limit the reporting to the top quartile of taxpayers
We have not adjusted for that difference in estimated self employement tax as that calculation is
complex. Instead we have adjusted the overall misreported tax by the overall top 25 rate(g30)_
without eliminating the lower income exemption. This understates the gain related to
self-employement tax

The source of the data in this spreadsheet is the following:
Internal Revenue Service Research, Applied Analytics & Statistics
Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013 Publication 1415 (Rev. 9-2019)
Washington, DC Sep-19

Exhibit 4: Tax Gap, Calculation of Gain from Medium Passthroughs

Exhibit 4 -1 Tax Gap Gain pasthroughs Update 1 **Includes all passthroughs** **allows for ownership exclusion**

Calculation of tax gain related to proposal for additional third party reporting of business income of S corportions and Partnerships

under $25 million receipts with reconciliation schedule and advanced technology

This sheet calculates the tax gain from the reform proposal as applied to S corporations and partnerships

In this update, passthroughs required to have third party reporting would be those with an ownership interest by individual taxpayers who meet the AGI criteria, either 400,000, or to 25% ($85,000) AGI

It differs from the calculation as a basis for the tax notes article published in September 2020, as follows

it

it does not exclude passthroughts over $25 million from the calculation

It does not exclude passthroughts with under $25,000 gross receipts

It makes an estmate of the maximum revenue lost from passthroughts that do not meet the ownership criteria

It first divides passthroughts below the $25 million threshold for large passthroughs. It further divides the passthroughs to those with receipts under and over $500,000.

The IRS compliance study of S corporations found different levels of misreporting for two similar size categories., using a threshold of $200,000 in 2004 dollars

We used a threshold of $500,000 as the most similar size category availabe in 2013 data. For those under the lower threshold, the misreporting percentage is comparable to sole proprietorship while for those over the threshold the misreportiing perentage is half that of sole proprietorships

This sheet calculates the tax gain based on the ratio of income for each size category of passthrough to that of individual business income, most of which is sole proprietor income and then applies the appropriate misreporting percentage. Finally it applies the tax gain percentage as derived in the analysis of individual business income underreporting. It adjusts for the fraction from existing enforcement and for the exemption of passthroughs under $25,000 receipts. Partnership income is adjusted for income received from other partnerships.

An estimate of the gain from large passthroughs is estimated by extrapolation from the medium sized passthroughs

dollars in thousands

	All		Under 500,000 receipts		500,000 to 25 million receipts	total mid-sized passthroughs	Over 25 million	
Number of returns								
Sole proprietors	24,074,684				NA			
S-corporations	4,257,909		3,041,574		1,191,218	4,232,792	25,118	
Partnerships	3,460,699		2,486,791		902,585	3,389,376	71,323	
total S-corporation	7,718,608		5,528,365	-	2,093,802	7,622,168		
Total Receipts								
S-Corporations	$ 6,745,095,028		381,378,110		3,117,878,491	3,499,256,601	############	
Partnerships	$ 5,068,975,400		547,224,287		1,847,789,041	2,395,013,328	############	
total s corp and partr	11,814,070,428		928,602,397	-	4,965,667,532	5,894,269,929	5,919,800,499	
Positive business income, all sources:								
Sole proprietors	357,417,038							
S-corporations	455,520,185		71,754,889		206,506,467	278,261,356	177,258,829	
Partnerships	647,046,634		88,033,966		265,019,076	353,053,042	293,993,592	
Total Pass	1,102,566,819		159,788,855		471,525,543	631,314,398	471,252,421	
estimated income below $25000 receipts			23,000,000					
Ratio of total Passthrough Income to sole propri			44.7%		131.9%		131.8%	
dollars below in billions								
Calculation of Gain								
ratio of TPT income to sole proprietor income			44.7%	131.9%			131.8%	
ind bus income NMA	109							
calcualted NMA for TPT								
based on ratio of TPT income to ind bus income			48.73	143.8			143.7	
ratio of TPT NMP to ind bus income NMP			1	0.5			0.33	
nma for pws			48.73	71.90		120.63	47.43	
fraction gained (see tax gap tab)			0.69	0.38	total gain		0.06	
gain from passthroughs			33.62	27.32	60.95	63.79	2.85	Note this gain of 2.85 billion is on income of 471 billion
adjustment for exemption under 25000 receipts			-		-			A net gain of only 0.6%
gain after exemption					60.95	63.79		
adjustment for enforced and late payements through existing enforcement					4.27	4.47		
see appendix for discussion		0.07						
net gain after existing enforcement					**56.68**	**59.33**		
Fraction of passthrough income excluded due to ownership exclucsion								
breakeven fraction	10%	top 25% taxpayers actually have 97% of category 3 income				**5.93**		
Net Gain						**53.39**		**Note this compares to a gain of 52.18 in september 2020 estimate Essentially the same gain**
net gain rolled forw	1.243623063				70.49			
total receipts rolled forward to 2019					7,330,250,023			
net gain as % of receipts					1.0%			
Business Income rolled forward to 2019					785,117,145			

The IRS 2011-2013 compliance study identified 109 billion of tax gap due to underreported business income

About 64% of this was from sole priopriretor income.

we use sole proprietor income as the best estimate for comparisons to mid sized passthroughs

Sources:

TY 2013 forms 1040, 4797, 1065, and 1120S, dollar amounts in $ 000

DEG Analysis by receipts size

Internal Revenue Service

Research, Applied Analytics & Statistics

Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013 Publication 1415 (Rev. 9-2019)

Washingto Sep-19

Shrink the Tax Gap, Inc. History and Biographies

Our History and Objectives

Shrink the Tax Gap is a non-profit entity organized under section 501(c)4 of the Internal Revenue Code.

Purpose – Our purpose is to make the Federal tax system fair for everyone who pays their taxes by proposing plans to increase overall compliance, raising more revenue from taxes already in the tax code, and making it faster and easier to interact with the IRS.

Sponsorship – Our organization has two directors: Charles O. Rossotti and Fred L. Forman, both private citizens. We have no affiliation with or sponsorship from any other individuals or entities.

Relationship to the IRS – Our work has been done entirely with public data and without any consultation with or support from the IRS or any current IRS employees. One retired IRS employee was paid to provide part-time administration support such as document preparation and scheduling. Other former IRS employees have voluntarily and without compensation chosen to comment on our articles and some have posted comments on our web site.

Employees and Vendors – We have no employees. As noted above, we pay one part-time person to provide administrative support. We pay other vendors and service providers on a commercial basis.

Funding – To date all funding has been provided personally by Charles O. Rossotti. We do not plan to solicit any funds from other parties. In the future, if we accept funding from any third parties, we will disclose those donors on our website.

Background Statements for Charles Rossotti and Fred Forman

Charles Rossotti served as IRS Commissioner from 1997 to 2002 and on President Bush's panel on tax reform in 2005. Since then, I have not been involved in any tax professional activities and I am not a tax advisor to anyone. I have been and continue to be engaged in business and non-profit activities, including serving as a part time advisor to The Carlyle Group. My principal business activity is investing and serving on the boards of companies. My work on the Shrink the Tax Gap program is not connected in any way with The Carlyle Group or any business entity.

In 2019 as the presidential campaigns got underway, it became apparent to me that the Federal Government would face a very difficult financial challenge over the next decade as demands for spending and tax relief would be high while the budget deficit was already high and growing. I believed that whatever else was done to resolve this dilemma part of the solution should be a more sound and fair tax administration system that collected more of the taxes already in the tax code. I drafted a proposal for this purpose, based on ideas I had been thinking about since my years as IRS Commissioner and on President Bush's tax panel. This culminated in an article I published in the journal *Tax Notes* in March 2020. At that time, I did not plan to do anything more on the subject.

After the first *Tax Notes* article was published, I received a number of generally positive inquiries and indications of interest in my proposal. Many of the inquiries were about how the proposal could be implemented. Based on this response. I decided to develop the proposal in more detail. At this time, Fred Forman joined me in the work.

Fred Forman was our senior technology executive at American Management Systems where I was CEO. From 2000 until 2004 he joined the IRS as Associate Commissioner for Business Systems Modernization. Since then, he has done occasional consulting for businesses and is engaged in various non-profit activities. He is not involved in tax advisory or other tax related activities.

In September we co-authored a second article in *Tax Notes* providing more details on how our proposal could be implemented. We also updated our website www.shrinkthetaxgap.com to provide more information on our Shrink the Tax Gap plan and to post comments.

Based on comments received on our articles we continue to update the plan. All updates are posted on the website.

In September we started to discuss our plan with interested parties and to obtain feedback and support. We continued to post news coverage and comments on the website. Some individuals who posted comments are also reaching out to discuss the proposal with their personal networks. In addition, we set up Shrink the Tax Gap pages on various social media networks.

In November 2020 Fred Goldberg joined our team

On January 14, we incorporated Shrink the Tax Gap, Inc. as a 501(c)4 organization to manage our activities more formally. Before this incorporation, we managed our activities as individuals.

In April 2021 David Borden, a lawyer and economist, joined our team.

We will continue to update our plan as we receive comments and suggestions. We will reach out to and work with all those interested in our ideas on how to improve the fairness and effectiveness of the tax system. All of us working on the program view this as a public service activity that we can now do as private citizens, much as we did public service as government officials earlier in our careers. It is a way we believe we can make constructive use of our years of experience in business, government and technology.

Summary Biographies

Charles O. Rossotti

Charles Rossotti has worked in business for 46 years and in government for 9 years.

Business Experience

In 1970, Rossotti co-founded American Management Systems, an Information Technology services and software company and served at various times as President, CEO and Chairman until 1997.

During Rossotti’s tenure, the company grew from a startup to a company with over 7,000 employees and its market value increased to over 300 times its initial value. In 1979, AMS was one of the first IT services companies to become publicly owned and it remained public until it merged with CGI in 2003

He has served as an advisor to a private equity investment company, The Carlyle Group, for the last 16 years.

In addition to his experience as a company founder, CEO and investor, Rossotti has served on the board of directors of 20 companies of all sizes, both publicly and privately owned. These include AES Corporation, Booz Allen Hamilton, and Bank of America, as well as many early-stage and mid-stage growth companies.

On various of these boards, he has served as non-executive chairman of the board, chair of the audit committee or chair of the finance committee.

He began his business career as a consultant at the Boston Consulting Group.

Government Experience

Rossotti had two terms of full-time service in government, in both cases serving both Democratic and Republican administrations.

From 1965 to 1970, he served in the Department of Defense, completing his service as Principal Deputy Assistant Secretary for Systems Analysis.

In 1997, Rossotti was appointed IRS Commissioner by President Clinton. He remained in this post for the first two years of the Bush Administration, completing his service in 2002.

In 2005, Rossotti was appointed by President Bush to a nine-person panel to recommend reform of the tax code.

Other Activities

Rossotti has also served on many non-profit boards and committees, including those of Georgetown University, the Advisory Board for the Graduate Business School of Carnegie Mellon University, Capital Partners for Education in Washington, DC., National Cathedral School, Potomac School, the Comptroller General's Advisory Committee of the Government Accountability Office (GAO) and the Tax Policy Center.

Rossotti is the author of *Many Unhappy Returns*, a book about his experience turning around the IRS, published by Harvard Business School Press in March 2005.

Education

A.B. Economics, Magna cum Laude, Georgetown University, 1962

M.B.A *with High Distinction, Harvard Business School, 1964*

Honors

Department of Defense: Distinguished Civilian Service Medal, 1970

Georgetown University, Honorary Degree 1998

Department of Treasury: Alexander Hamilton Medal, 2002

Harvard Business School, Alumni Achievement Award. 2003

Fred L. Forman

Fred L. Forman was Executive Vice President and senior technology officer at American Management Systems from 1971 until 1997, when he became AMS's General Manager for Europe. In 2000 he joined the Internal Revenue Service as the Associate Commissioner for Modernization serving until 2004, after which he did strategic technology consulting for several private and public sector organizations. Over the last several years, he has served as an officer and Board member for several non-profit organizations.

Business Experience

- In 1971, joined American Management Systems as senior technical systems analyst and worked on early projects for various businesses, such as Boise Cascade, New York City Health and Hospitals Corporation.
- For AMS, became Executive Vice President and senior technical officer, working on major projects for banks, telecommunications firms, universities, state and local governments, federal government agencies and more.
- Also responsible for corporate systems planning, development and management best practices. Established the AMS Center for Advanced Technologies.
- From 1997-2000 was General Manager for AMS Europe, clientele primarily in the telecommunications and banking industries.
- After retiring from the IRS, was an independent consultant to several private, public and international organizations, including the International Monetary Fund and the Inter-American Development Bank.
- Have been on several corporate and non-profit Boards.

Government Experience

- In 1969, went to work as systems analyst for Lambda Corp, doing software development in support of complex mathematical models for the Defense Department and other government agencies.
- From 2000-2004 led the US Internal Revenue Service Modernization program, initially as Associate Commissioner for Modernization, then as Associate Chief Information Officer
- BS, Physics, Case Institute of Technology (1965)
- MS, PhD, Physics, University of Pennsylvania (1967, 1969)
    - Discovered elementary particle in thesis research

Awards and Honors

- Federal Top 100 Award (2002)
- IRS Commissioner Awards (2002, 2004)
- IRS Chief Information Officer Awards (2003, 2004)
- American Kennel Club Outstanding Sportsmanship Award (2018)
- Numerous articles in computer and physics technical publications

Fred Goldberg

Government Service

Goldberg was appointed by President George H.W. Bush to serve as IRS Commissioner (1989-1991) and Assistant Secretary of the Treasury for Tax Policy (1992). He had previously been appointed by President Ronald Reagan as the IRS Chief Counsel (1984-1986), He previously served as Special Assistant to IRS Commissioner Roscoe Eger (1981-1983) and prior to graduating from law school he worked as Special Assistant to the Director of Planning & Research, Office of Economic Opportunity (1970). He also served as staff director of the Kerry-Danforth Entitlements and Tax Reform Commission (1993-94) and as a member of the Kerry-Portman IRS Restructuring Commission (1996-1997).

Private Sector Professional Experience

Goldberg has practiced tax law in the private sector for more than 35 years. He is currently Of Counsel in the Washington, DC Office of Skadden, Arps, Slate, Meagher & Flom. In addition to his ongoing professional responsibilities, he serves as co-chair *emeritus* of the Firm's global Diversity, Equity & Inclusion and Pro Bono Committees.

Other Activities

Goldberg has also served on many non-profit boards and committees focused on issues of health care, education, and wealth building opportunities in underserved communities. His non-profit board and advisory committee memberships have included: Children's National Hospital of Washington, DC; New York City Kids RISE; Build Commonwealth (f/k/a Doorways to Dreams); Future Scholars Fund; Prosperity Now (f/k/a Corporation for Economic Development); and the Get Your Refund initiative of Code for America.

David P. Borden

David Borden has a background in tax law, finance, and economics.

Private Sector Experience

- From 2005 to 2007, was a research assistant at the National Bureau of Economic Research focusing on retirement savings and behavioral economics
- From 2007 to 2010, was a quantitative analyst at Goldman Sachs's quantitative mutual and hedge funds with a focus on equity and trading research
- From 2013-2015 and 2016-present, am a tax lawyer at international law firm with a focus on tax controversy and compliance matters

Education

- A.B. in Economics, Harvard College (2005)
- J.D., Georgetown University Law Center (2013)

Government Experience

- From 2015-2016, was a law clerk to Judge Paul W. Grimm, United States District Court for the District of Maryland