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Updated ‘tax gap’ estimates will be ready by summer, Rettig says

The Internal Revenue Service expects to release an updated estimate of what’s informally known as the “tax-gap”—the difference between the amount of tax owed to the government and the amount actually paid on a timely basis—by this summer, Commissioner Charles Rettig told Senate taxwriters on April 7.

Rettig made his comment during a Senate Finance Committee hearing to examine the Biden administration’s proposed fiscal year 2023 budget for the IRS and the status of the 2022 tax filing season.

Tax gap

The most recent official estimate from the IRS (covering 2011-2013) puts the gross annual tax gap at $441 billion and the net annual tax gap at $381 billion. (The net tax gap is the gross amount less any tax eventually collected through enforcement efforts or late payments.) Commissioner Rettig stated in 2021 that the gap may now equal or exceed $1 trillion a year. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 20, Apr. 16, 2021.) He recently told members of the House Ways and Means Oversight Subcommittee that he still stands by that estimate. (For prior coverage, see *Tax News & Views*, Vol. 23, No. 9, Mar. 18, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210416_3.html
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220318_1.html

At this week's Finance Committee hearing, Rettig told Chairman Ron Wyden, D-Ore., that the forthcoming estimate from the IRS will cover the period from 2014 through 2016 and will include projections for 2019. Rettig noted, though, that these new estimates and projections will not reflect the impact of virtual currency transactions and "certain foreign-source income."

"We're working to get that information," he told Wyden, "but we're not where we need to be." According to Rettig, the IRS is aware of "significant noncompliance" with information reporting requirements in the virtual currency realm. There is currently about $14 trillion in virtual currency transactions worldwide, Rettig said, and the US accounts for between 30 and 40 percent of that activity. He added that while reporting levels have shown some degree of improvement, they remain unsatisfactory.

Wyden, for his part, urged the Service to produce tax gap estimates that are more current and provide greater detail into which classes of taxpayers are responsible for the shortfall in payments. That data, he said, is "essential for a lot of the debates we're having" in Congress. Wyden also offered to work with the Service to determine what resources it needs from Congress to make those detailed estimates possible.

Budget highlights

The administration's FY 2023 budget blueprint, which was released March 28, calls for an overall allocation of $14.1 billion for the IRS, an increase of nearly 12 percent over the $12.6 billion enacted in the long-delayed budget agreement for FY 2022, which President Biden signed into law on March 15. (For details on the FY 2022 budget, see *Tax News & Views*, Vol. 23, No. 8, Mar. 11, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220311_1.html

On a program level, FY 2023 proposal includes $3.7 billion for taxpayer services (compared to $2.8 billion enacted for FY 2022), $6.3 billion for enforcement (FY 2022 enacted: $5.4 billion), $3.8 billion for operations (FY 2022 enacted: $4.1 billion), and $310 million for business systems modernization (FY 2022 enacted: $275 million).

Unlike the FY 2022 blueprint, the administration's latest budget request for the Service does not include an additional 10-year allocation that would be dedicated primarily to beefing up enforcement resources. (The White House proposed an $80 billion set-aside for enforcement in FY 2022 and congressional Democrats provided for a similar allocation in the Build Back Better legislation that cleared the House last November but is now stalled in the Senate.)

The Treasury Department stated in a news release that was issued in conjunction with the FY 2023 budget package that "the administration continues to support multiyear investments in IRS tax enforcement to increase tax compliance and revenues that the president has previously proposed."

In addition to the proposed funding increase for the IRS, the budget blueprint also includes several targeted administrative measures that are intended to increase tax collections by tightening taxpayer compliance rules. (For a discussion of notable revenue provisions in the FY 2023 budget package, see *Tax News & Views*, Vol. 23, No. 12, Mar. 29, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220329_1.html

Taxwriters touched on a number of specific elements of the administration's proposed budget for the Service during the hearing and, as has been the case in several recent hearings this year on both sides of the Capitol related to IRS funding, the ensuing discussion sometimes left lawmakers divided along party lines.

Compliance and enforcement

Finance Committee Democrats lauded the administration's proposal to increase the IRS's overall budget for fiscal year 2023 and were particularly supportive of the proposed spike in funding for enforcement.

Chairman Wyden contended in his opening statement that years of congressionally mandated cuts to the Service's budget have diminished the ranks of experienced revenue agents and, as a result, created increased opportunities for tax evasion by large corporations, partnerships, and wealthy individuals that have the resources to engage in complex, sophisticated transactions.

But the top Republican on the panel, ranking member Mike Crapo of Idaho, was wary of what he characterized as proposals to generate revenue through "heavy-handed enforcement" and expressed concern about "huge funding boosts that would increase audits on small businesses and middle-class Americans rather than prioritize taxpayer services." Crapo also criticized the "massive $80 billion of mandatory funding" (over 10 years) for IRS enforcement efforts in the administration's fiscal year 2022 budget package and in the House-passed Build Back Better legislation and vowed to ensure that such a proposal never becomes law.

Democratic taxwriter Elizabeth Warren of Massachusetts, meanwhile, argued that a multiyear funding boost for enforcement would give the IRS the tools it needs to implement the administration's proposed minimum tax of 20 percent on total income, generally inclusive of unrealized capital gains, for all taxpayers with wealth greater than $100 million. (Warren called the minimum tax proposal "a giant step forward" in preventing tax avoidance among ultra-wealthy individuals.)

Warren asked Commissioner Rettig about a claim leveled by critics of the proposal that the IRS lacks the capacity to implement a tax of this type. Rettig replied that the IRS already has expertise in complex asset valuations based on its history in auditing large estates and said that a multiyear infusion of funds for enforcement programs would give the agency the tools it needs to effectively administer the proposed new tax.

“We have the most sophisticated financial examiners on the planet . . . and we need to support them by providing them meaningful tools, resources, and training,” Rettig said. That level of investment would, in turn, help restore the IRS’s reputation “a place where tax professionals want[] to go,” he added.

IT modernization

There was greater bipartisan consensus on the panel around the need to modernize the Service’s information technology infrastructure, which consists of a patchwork of antiquated systems—some of which date back to the 1960s—that are poorly coordinated.

Several Finance Committee Republicans—including ranking member Crapo, Sen. Charles Grassley of Iowa, and Sen. Steve Daines of Montana—nonetheless pressed Rettig to explain why the IRS has not been able to bring its IT systems up to date despite the billions of dollars Congress has allocated to those efforts in recent years.

Rettig commented in response that the modernization plan the Service developed in 2019 was reviewed by outside consultants and modified based on their recommendations, but its implementation has been frustrated by the fact that the Service to date has received only 57 percent of the funds that Congress allocated. The inconsistent delivery of funding presents an additional problem, he explained, noting that the IRS, like other government agencies, has had to conduct business through more than 100 continuing resolutions from Congress since 2001. (He noted that an agreement on funding levels for FY 2022, which began on October 1, 2021, was not finalized until just last month.)

In an exchange with Democratic Sen. Tom Carper of Delaware, Rettig said it is “impossible to build a robust, meaningful information technology infrastructure . . . when we don’t have consistent, timely, multiyear funding. . . . We consistently have to push projects off based on [funding] limitations.”

Pandemic processing backlog

Taxwriters from both parties asked Rettig about the steps the IRS is taking to reduce the pandemic-related backlog of unprocessed returns from tax year 2020 and 2021 and when the agency expects the issue to be resolved.

Rettig replied that the Service expects to hire 10,000 new employees this year (in two separate tranches of 5,000 each) to address unprocessed returns and other taxpayer correspondence. He also noted that Congress “rescued” the IRS in the just-enacted FY 2022 budget agreement by giving it direct-hire authority for this effort, which will allow the agency to onboard new hires in just 30-45 days. (Under ordinary government hiring procedures, onboarding new employees typically takes anywhere from six to eight months, he said.)

As part of its all-out hiring push, the IRS recently held job fairs at its three major processing centers and extended job offers to over 2,200 prospective employees who attended, Rettig said.

Echoing comments he made during a recent appearance before the House Ways and Means Oversight Subcommittee, Rettig told Senate taxwriters that barring any operational disruptions resulting from an unexpected spike in the COVID pandemic, the Service projects that the backlog should be reduced to a "healthy" level by the end of this calendar year.

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Republican tax leaders raise additional concerns over global tax agreement

Congressional Republican criticism of the Biden administration's approach to an overhaul of global tax rules continued this week as GOP members of the Senate Finance Committee added to their recent exchange of letters with Treasury officials to decry the administration's "insufficient level of engagement and consultation" with Congress in negotiating in last year's international tax agreement led by the OECD and G-20; meanwhile, the top GOP taxwriters in both chambers pointed to recent news out of the EU as a reason to step back from implementing the pact.

Insufficient engagement

After receiving two lengthy replies from the Treasury Department in March to letters sent last December and in February addressing concerns with both pillars of the global agreement, Senate Finance Committee Republicans on March 31 sent another missive to Treasury Secretary Janet Yellen, saying that the level of engagement they perceive from her department "does not convey that Treasury views our input as necessary or critical." (For details on the two previous letters and Treasury's responses, see *Tax News & Views*, Vol. 23, No. 13, Apr. 1, 2022.)
URL: https://www.finance.senate.gov/imo/media/doc/finance_republicans_yellen_follow-up_3_31.pdf
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220401_3.html

Responding to the Treasury's claims that it had consulted with Congress in the course of its negotiations on the global tax agreement, Finance Committee Republicans commented in their March 31 letter that "briefings provided by Treasury to certain [c]ongressional staff . . . merely informed certain staff of negotiations after they had occurred, and in most cases, after developments were publicly announced and the corresponding documents were publicly released." According to the GOP taxwriters, "[a]fter-the-fact briefings with committee and leadership staff do not constitute meaningful consultation."

The Republicans went on to note multiple elements of the agreement the administration signed on to last October that are "in direct opposition" to the stated views of the GOP. Among the specific issues cited are the agreement's more favorable treatment of refundable tax credits over nonrefundable credits, which are more prevalent in the US; its failure to include a provision deeming current US law to be compliant under the Pillar 2 global minimum tax; and the administration's proposal to eliminate the US's foreign-derived intangible income (FDII) provision. (The letter noted that FDII is supported by a number of Democrats, as well as Republicans.)

The GOP letter also criticized the request by Assistant Secretary for Legislative Affairs Jonathan C. Davidson for input on the marketing and distribution safe harbor in Pillar 1 (reallocation of global taxing rights) in his March 1 letter to the senators.

"[T]he Assistant Secretary does not provide any data on the 'tradeoffs,' specific options on the table, or any meaningful information to allow us to provide constructive feedback," the senators said in their latest letter. "Such actions do not reflect a Treasury Department that believes Congress should play a meaningful role in these negotiations, or that its views should be taken into account."

The senators emphasized that they believe the administration should revisit certain aspects of the global deal. Although more than 140 countries signed on to the agreement last October, the taxwriters said they believe "there is still time to change course" because "the clearly unrealistic [implementation] timeline is already slipping."

"As we have stated many times, implementation of this agreement would require [c]ongressional action, including Senate approval of a multilateral tax treaty," they wrote, urging Treasury to conduct in-person briefings and hearings.

Speedbump in Europe

The timeline for implementing the global agreement was pushed even further into the spotlight this week as the EU's finance ministers failed on April 5 to reach the necessary unanimity on the Pillar 2 minimum tax proposals in a draft directive put forth by the European Commission at the end of December, and modified in March by France (in its capacity as the current head of the Council of the EU) to have a delayed effective date. Under the proposed delay, one of the three principal rules of Pillar 2, the income inclusion rule (IIR), would go into effect in 2024, and another, the undertaxed payment rule (UTPR), in 2025. Each of these is a year later than originally anticipated.

It is not yet clear whether the France will try again for unanimity before it hands off leadership of the Council of the EU to the Czech Republic on June 30. Many in the international tax world believe that if the EU fails to get an agreement on Pillar 2 by the end of 2022, it will signal trouble for Pillar 2 around the world.

The EU's failure so far could be problematic for the Biden administration as it seeks to have the US conform to Pillar 2 this year by raising the rate on the current minimum tax—imposed on global intangible low-taxed income (GILTI)—to 15 percent and applying GILTI on a country-by-country basis. Republicans—and some Democrats—have raised concerns about having the US implement Pillar 2 before other countries do so, arguing that this will put US companies at a competitive disadvantage.

The administration's challenge was highlighted by an April 5 statement from the senior Republicans on the Senate Finance Committee and the House Ways and Means Committee—Sen. Mike Crapo of Idaho and Rep. Kevin Brady of Texas, respectively—who said that said the holdup in the EU is a reason for the US to put on the brakes.
URL: https://www.finance.senate.gov/ranking-members-news/crapo-brady-warn-against-partisan-pitfall-laden-path-forward-on-global-minimum-tax

"EU finance ministers have again failed to agree on the global minimum tax, further evidence that the Biden [a]dministration was premature in taking a victory lap on the OECD [a]greement," Crapo and Brady said. "If the EU is already hitting roadblocks, no one should expect countries like China to implement this deal anytime soon. The Biden [a]dministration has neglected to consult with Congress in this process, and the result is a bad deal for American businesses and workers. The [a]dministration should abandon its failed go-it-alone approach and work with Congress to negotiate a deal that protects US economic strength."

— Storme Sixeas
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Familiar divisions emerge as Ways and Means Committee explores disparate impacts of tax policy on communities of color

Democrats and Republicans on the House Ways and Means Committee found little to agree on during an April 6 hearing that explored how the benefits of federal policies under the committee's jurisdiction—including the nation's tax laws—may be felt differently by various racial groups.

Democrats tout ARP tax credit expansions, cite tax code inequities

Although much of the hearing focused on expanding health coverage, trade, Social Security, paid leave, the federal minimum wage, and other policies not directly related to the tax code, Democratic taxwriters used the forum on a handful of occasions to express their support for—and encourage the extension of—expansions of the child tax credit, earned income tax credit, and child and dependent care tax credit that were enacted on a temporary basis early last year in the American Rescue Plan of 2021 (ARP, P.L. 117-2). (For prior coverage of the ARP, see *Tax News & Views*, Vol. 22, No. 11, March 10, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210310_1.html

Tax credit expansions: Those tax credit expansions—which included an increase in the maximum child tax credit and advanceable monthly payments for certain households, an increase in the earned income credit (EITC) for individuals without dependents, and full refundability of the child and dependent care credit—all expired at the end of 2021.

“There is no denying that the American economy does not work for everyone,” said Chairman Richard Neal, D-Mass., as part of his opening statement. “Enhancing the EITC and closing the Medicaid coverage gap are examples of policy decisions that can help change our nation’s trajectory and improve outcomes for everyone.”

Rep. Jimmy Gomez, D-Calif., made a similar argument with respect to the ARP’s temporary child credit enhancements.

“We’ve made a couple of simple changes to the child tax credit and, lo and behold, we had a reduction in child poverty in this country to 40 from 60 percent depending on the community you lived in,” Gomez said.

The near-term fate of these and other Democrat-favored tax policies is likely inextricably linked to the success or failure of Democrats’ “Build Back Better” legislation (H.R. 5376), which passed the House of Representatives on last November, but which currently remains stalled in the upper chamber as Senate Democrats as Democrats endeavor to find a mix of spending and tax policies that can win the favor of all 50 members of their caucus. (A detailed summary of the tax provisions in the House-passed legislation is available from Deloitte Tax LLP.)
URL: https://www2.deloitte.com/us/en/pages/tax/articles/build-back-better-tax-legislation.html?id=us:2em:3na:tnv:awa:tax:040822&sfid=7015Y000003WdDYQA0

Structural inequities in the tax code: For her part, Democratic Rep. Terri Sewell of Alabama homed in on certain tax provisions whose benefits disproportionately flow to higher-income households—a dynamic that she argued perpetuates income and wealth inequities between white households and those of color.

“While the tax code never mentions the word ‘race,’ the policies that we have promulgated in this committee over the years have . . . increase[d] the wealth gap for communities of color,” Sewell said. “Black households are less likely than white households to receive tax-free gifts or inheritance, to own financial assets that generate tax-advantaged . . . capital gains, or to generate capital gains at the same rate as white households.”

Reps. Sewell and Gomez, along with fellow taxwriter Rep. Steven Horsford, D-Nev., lead a working group known as the Racial Equity Initiative that Chairman Neal announced last year. The working group’s primary charge is to make recommendations on “justice-forward legislation” for the committee. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 12, Mar. 12, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210312_3.html

Ways and Means Democrats also published a report last year entitled *Something Must Change: Inequities in US Policy and Society*, as well as a framework of policy pillars and priorities for legislation. In the economic equity area, the framework includes approaches such as eliminating barriers to work and job training caused by poverty and systemic racism, extending the work opportunity tax credit, and guaranteeing paid leave for all US workers.
URL:
https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/WMD%20Health%20and%20Economic%20Equity%20Vision_REPORT.pdf

URL:
https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/FINAL%20WMD%20Health%20and%20Economic%20Equity%20Vision%20Policy_FRAMEWORK.pdf

GOP talks up TCJA, hits Democrats over inflation levels

For their part, Republicans on the panel expressed a markedly different view of how the federal government should respond to economic disparities among races, with a number of GOP members touting the economic benefits of their Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97), including provisions allowing for the full and immediate expensing of certain capital investments, a 20 percent deduction on the qualified business income of certain passthrough businesses, and the Opportunity Zone program, which provides tax relief on capital gains rolled over into investments into designated geographic areas.

"[The TCJA] leapfrogged America to the best economy in the world, lifted six million Americans out of poverty, brought back jobs from overseas, and created hope and opportunity for workers and people of color who had been left behind in the old Obama-Biden tax code," said ranking member Kevin Brady, R-Texas.

Brady also contended that the coronavirus relief and stimulus-focused American Rescue Plan—which Democrats moved through Congress last year under the filibuster-proof budget reconciliation process—has led to currently high levels of price inflation and thus has exacerbated economic inequities.

"Democrats in Congress rammed through a partisan $2 trillion so-called 'COVID stimulus' that sent inflation skyrocketing to 40-year highs," Brady said of the ARP. "As a result, price hikes at the pump, for food, supplies, housing, and transportation are crushing working families—especially people of color."

Rep. Tom Rice, R-S.C., speaking later at the hearing, called inflation "a regressive tax" that "hits the poor the hardest."

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