

Understanding the Tax Gap and Taxpayer Noncompliance

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

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UNDERSTANDING THE TAX GAP AND  
TAXPAYER NONCOMPLIANCE

Thursday, May 9, 2019

House of Representatives,

Committee on Ways and Means,

Washington, D.C.

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**Witnesses****The Honorable J. Russell George**

Treasury Inspector General for Tax Administration (TIGTA), U.S.  
Department of the Treasury

**James R. McTigue**

Director, Tax Issues, Strategic Issues, GAO

**Benjamin Herndon**

Chief Research and Analytics Officer, IRS

**Kenneth Wood**

Former IRS Deputy Associate Chief Counsel, Office of Chief Counsel  
(International), IRS



**HOUSE COMMITTEE ON WAYS & MEANS**  
CHAIRMAN RICHARD E. NEAL

***ADVISORY***  
**FROM THE COMMITTEE ON WAYS AND MEANS**

FOR IMMEDIATE RELEASE  
May 2, 2019  
No. FC-10

CONTACT: (202) 225-3625

**Chairman Neal Announces a Hearing on Understanding the Tax Gap and Taxpayer Noncompliance**

House Ways and Means Chairman Richard E. Neal announced today that the Committee will hold a hearing titled “Understanding the Tax Gap and Taxpayer Noncompliance.” The hearing will take place on Thursday, May 9<sup>th</sup> at 10 AM in room 1100 Longworth House Office Building.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

**DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select “Hearings.” Select the hearing for which you would like to make a submission, and click on the link entitled, “Click here to provide a submission for the record.” Once you have followed the online instructions, submit all requested information. Please indicate in the subject line of your email the hearing for which you wish to submit for the record. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Thursday, May 23, 2019**. For questions, or if you encounter technical problems, please call (202) 225-3625.

**FORMATTING REQUIREMENTS:**

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but reserves the right to format it according to guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you require special accommodations, please call (202) 225-3625 in advance of the event (four business days' notice is requested). Questions regarding special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

**Note:** All Committee advisories and news releases are available at <http://www.waysandmeans.house.gov/>

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The Committee met, pursuant to notice, at 10:00 a.m., in Room 1100, Longworth House Office Building, Hon. Richard Neal, [Chairman of the Committee] presiding.

\*Chairman Neal. The committee will come to order.

Good morning and welcome to our witnesses and audience members. I want to thank you all for being here.

Last month most hardworking, honest Americans timely filed and paid their taxes. Today we will examine the costs associated with those who did not, including the lost revenue and lost confidence in our tax system.

Our hearing today will focus on understanding the tax gap. This is not a new issue. One of our colleagues here, Bryon Dorgan, brought this issue up many, many years ago as a member of this committee before he was elected to the Senate.

This will provide a rough estimate of the level of overall noncompliance with our Federal tax laws. The most recent Internal Revenue Service estimate of the annual gross tax gap is about \$460 billion, and after enforcement activities and late payments, the net amount is \$400 billion a year.

Despite this astounding number, the true tax gap is greater than what the IRS estimates. This is because the IRS estimate does not include taxes owed on income from illegal activities or taxes avoided on certain international activities.

The tax gap simply represents the estimate of different types of noncompliance with our individual corporate and other tax laws.

First, there is noncompliance in the form of underreporting, which includes taxpayers who understate their income or overstate their deductions, exemptions, or credits. Taxes related to this underreporting account for nearly \$390 billion of the gross tax gap.

Second, there is noncompliance by taxpayers who file their tax returns, but fail to

meet the deadline to pay what they owe. These underpayments account for about \$40 billion of the gross tax gap.

Third, there is noncompliance by taxpayers who are required to file a tax return and simply do not. Taxes on income of these non-filers account for about \$32 billion of gross tax gap.

Law abiding taxpayers must certainly be disturbed that over \$400 billion is not collected from those who are required to pay.

The amount of the tax gap that the IRS can collect depends on its funding and resources. Insufficient IRS funding creates incentives for some taxpayers to take aggressive tax positions. Well-advised taxpayers, including multinational companies and high-income taxpayers have the incentives and resources to do precisely that.

Testimony today notes that high income taxpayers have the most opportunity to engage in tax avoidance and the planning that accompanies it.

However, the IRS is not focusing on these taxpayers. Instead in 2017, the IRS targeted low income, earned income tax credit taxpayers. Many question why the IRS is using its limited resources in this manner rather than deploying them on high income tax earners and corporations where the return is greater per hour of a revenue agent's time.

Taxpayers are more compliant when they may be audited, but the overall audit rate has plummeted below one-half of 1 percent. IRS examination personnel have decreased by nearly 5,000 employees, or 38 percent, over 7 years.

Let me repeat that. Five thousand employees or 38 percent over 7 years, and the IRS revenue officers have decreased by over 1,600 employees, or 42 percent, during the same period.

With fewer officers, Treasury fails to collect billions of dollars each year. I look forward to hearing from our witnesses about their recommendations for closing the tax gap.

And with that, I recognize the ranking member, Mr. Brady, for an opening statement.

\*Mr. Brady. Thank you, Chairman Neal.

The tax gap is an important issue, and Republicans on this committee support closing it. The tax gap or the difference between tax amounts that taxpayers should pay versus what they actually pay has been a persistent problem for decades.

The IRS periodically estimates the tax gap using audit and other data it collects, and as of April of 2016, the agency estimates the gap was approximately \$458 billion in unpaid taxes per year between 2008 and 2010. This is clearly a problem.

Some say the solution is more agents, more audits and more intrusion into the private lives of taxpayers. We disagree. Republicans support closing the tax gap with better customer service, smarter audits, improved IRS assessment of the gap, and capitalizing on our simpler, improved tax code.

For starters, we need to make sure that taxpayers are provided the customer service they deserve. Most Americans want to pay the taxes they owe, but do have a hard time when questions arise and they cannot get through to get help. We need to make it easier, which is why we required the IRS to create a customer service strategy in the bipartisan Taxpayers First Act, which passed the House twice last year and again this year.

Thank you, Chairman.

Additionally, the IRS needs to better utilize the vast amount of information it collects to estimate the tax gap. In doing so, it is paramount that taxpayer rights and taxpayer privacy are protected.

The way the IRS currently estimates the tax gap comes at a huge personal cost to taxpayers, requiring significant time, in-person meetings, and tons of prep work.

If the IRS is going to put taxpayers through that experience, let's outline a strategy



on how it plans to use that information in a timely manner to close the tax gap.

Additionally, we know that in order to address this gap, we have to address our changing economy. This scenario I believe we can work together on. Gig economy workers, such as folks who drive for Uber, use their homes for Airbnb, contribute greatly to our economy.

We support innovation in our workforce and want to ensure these companies and these individuals can succeed. But as the Treasury Inspector General for Tax Administration has pointed out, who we will hear from today, recently discovered there is a greater risk of folks who participate in the gig economy of noncompliance.

TIGTA recommended to the IRS the agency develop a strategic plan to address tax administration in the gig economy, and the IRS agreed on its importance.

We believe the Congress must be involved in these discussions as well, helping workers comply with the tax code as needed to reduce the gap.

I know many on the other side of the dais today will cry foul, claim that Republicans have gutted the IRS over the years. The truth is the IRS budget has been stable over the last several years, and any cuts by Congress were made only when compared to an all time budget high.

The truth of the matter is IRS had lost its credibility and its trust during the Obama administration. Republicans are committed to ensuring that our Nation's tax administrator does its job it is built to do, administer our tax code, and we are open to making sure that they have the resources you need to do that.

Because especially as it concerns closing the tax gap, the solution must be myriad. There is no single approach that will fully and cost effectively address the tax gap. The IRS cannot audit its way out of the tax gap. Solving it requires multiple solutions across different types of taxes.

And as TIGTA has found, the IRS can be using its current resources more effectively. There are opportunities that exist to help the IRS complete smarter audits. GAO has recommended ways in which the IRS could allocate enforcement resources to maximize its audit results.

Before we discuss funding, let's take a look at the IRS' current standing. The agency does need to continue to show us capable, effectively managing its existing funds. The points we address today are simply a start.

We ought to work together to close this gap while protecting taxpayers, further simplifying our tax code, and improving customer service, while working with the IRS to achieve that.

Thank you, Chairman Neal, and I yield back.

\*Chairman Neal. Thank you, Mr. Brady.

And without objection, all members' opening statements will be made part of the official record.

We have a distinguished panel of witnesses here with us this morning to discuss the tax gap and taxpayer noncompliance with Federal regulations.

First I want to welcome the Honorable J. Russell George, the Treasury Inspector General for Tax Administration at the United States Department of the Treasury.

Next, Mr. James McTigue, the Director of Tax Issues and Strategic Issues for the United States Government Accounting Office, the GAO.

Then Mr. Ben Herndon, the Chief Research and Analytics Officer at the Internal Revenue Service.

And finally, Mr. Kenneth Wood, former IRS Deputy Associate Chief Counsel at the IRS, Office of Chief Counsel on the international side.

Each of your statements will be made part of the record in its entirety. I would ask

that you summarize your testimony in 5 minutes or less.

To help with that, there is a timing light on your table. When you have one minute left, the light switch from green to yellow and then finally to red when 5 minutes are up.

Mr. George, would you please begin?

STATEMENT OF THE HONORABLE J. RUSSELL GEORGE, TREASURY  
INSPECTOR GENERAL FOR TAX ADMINISTRATION, U.S. DEPARTMENT OF  
THE TREASURY

\*Mr. George. Thank you, Chairman Neal, Ranking Member Brady, members of the Committee.

Thank you for the opportunity to discuss the tax gap, as well as opportunities for the IRS to improve taxpayer compliance.

As you noted, the tax gap, or the difference between what taxpayers owe and what they pay timely, is estimated to be \$458 billion annually. After enforcement efforts, the estimated net tax gap is \$408 billion annually, a noncompliance rate of about 16 percent.

Increased compliance lessens the tax gap. IRS studies have shown that audits have the greatest impact on tax compliance. Due to diminished resources, the number of IRS examination personnel has decreased 38 percent from fiscal year 2010 to fiscal year 2017.

Accordingly, the number of audits has also decreased by 32 percent, from 1.6 million in fiscal year 2013 to 1.1 million in fiscal year 2017.

The IRS' fiscal year 2020 budget requests additional funding for compliance positions, which would enhance compliance efforts. TIGTA has identified compliance program improvements that would require little, if any, additional resources.

For example, a significant shift has taken place in our economy in the evolution of what is referred to as the gig economy, as was noted.

Technological innovations are positive and important to our economy. However, the IRS lacks a strategy to address this change. Billions of dollars in potential tax discrepancies involving taxpayers' earnings in the gig economy are not reported and addressed.

Due to this missed opportunity, many cases with discrepancies are being overlooked with thousands of gig economy related cases not scrutinized.

Furthermore, gig economy companies play by a different set of rules when it comes to reporting to the IRS what workers are paid. Certain gig economy businesses are not required to issue tax documents unless workers earn at least \$20,000, among other requirements.

The expansion of the gig economy has led to an information gap, which Congress should consider closing. When income information is not reported to the IRS, taxpayers tend to be much less tax compliant.

Another example involves tip income, which constitutes approximately 10 percent of the underreporting component of the tax gap. The IRS is not adequately examining noncompliance in this area.

The realm of virtual currencies continues to present a significant risk to tax administration due to the anonymity of transactions and the lack of third-party information reporting to the IRS. The IRS needs to develop a compliance strategy with respect to virtual currencies. It must provide additional guidance to assist taxpayers with their tax compliance and revised third-party information reporting documents to identify virtual currency related transactions.

Recent reviews we conducted found that the IRS lacks processes to address significant employer and payer noncompliance with reporting and remitting taxes withheld.

We are also preparing a report detailing the IRS' efforts to ensure compliance with non-payroll withholding tax reporting and payment provision. This review identified billions of dollars in non-payroll tax withholding discrepancies which are not being addressed.

In conclusion, the IRS can more effectively shrink the tax gap by developing

compliance strategies for our changing economy and use its revenue agent resources and information reporting more effectively to conduct tax audits.

Congress can assist by ensuring the IRS has the resources necessary to do its job and by reducing the information gap wherever possible.

Chairman Neal, Ranking Member Brady, members of the committee, thank you for the opportunity to share my view. This concludes my statement.

[\[The statement of Mr. George follows:\]](#)

\*Chairman Neal. Thank you, Mr. George.

With that let me recognize Mr. McTigue to begin.

STATEMENT OF JAMES R. McTIGUE, DIRECTOR, TAX ISSUES, STRATEGIC  
ISSUES, UNITED STATES GENERAL ACCOUNTING OFFICE

\*Mr. McTigue. Chairman Neal, Ranking Member Brady, and members of the committee, thank you for this opportunity to discuss the tax gap, which has been a persistent problem for decades.

In fact, enforcement of tax laws has been on GAO's list of programs that are at high risk, due to the vulnerability that waste, abuse, and mismanagement, or in need of transformation since we first compiled the list back in 1990.

Unfortunately, as others have noted, there are no easy fixes to this problem, and given persistent levels of noncompliance, reducing the tax gap will not likely be achieved through a single solution. Rather, the tax gap must be attacked on multiple fronts with multiple strategies over a sustained period of time.

Completely eliminating the tax gap is also not feasible. It would entail more intrusive enforcement and more burdensome recordkeeping and reporting than the public would be willing to accept and more resources than the IRS is able to commit.

However, even a modest reduction in the tax gap would yield significant financial benefits. For example, a 1 percent reduction in the tax gap would result in about \$4 billion more a year in revenue, clearly, not an insignificant amount. In fact, that is nearly the entire IRS budget for enforcement.

That amount would also fund the entire operations of the Census Bureau or the combined operations of the National Park System, the Smithsonian Institution, and the National Archives.

Addressing the tax gap is also important because tax noncompliance, even when unintentional, can discourage compliant taxpayers and undermine the integrity of the tax



system and the public's confidence in it.

Those who do not pay their taxes are shifting the fiscal burden to those who do pay. Noncompliance can also create an unfair competitive advantage among businesses. Again, those who do not pay their taxes are avoiding costs that tax compliant businesses incur.

GAO's work has highlighted three important factors that contribute to the tax gap. First, the extent to which individual taxpayers accurately report their income is greatest when their income is reported to them and to the IRS by a third party.

For example, when employers withhold taxes from and report information on wages, taxpayers misreported only 1 percent of such income. In contrast, taxpayers misreported over half of their business income for which there is little or no third-party information reporting.

Second, the final year covered by the tax gap estimate, 2010, was the high water mark of the IRS budget. Since then, IRS' budget has fallen to the point where it is 5 percent below the fiscal year 2000 level, when adjusted for inflation, this despite increasing responsibilities, such as implementing the Tax Cuts and Jobs Act and the Affordable Care Act, and growing threats from cyber criminals and identity theft refund fraudsters.

IRS has almost 40 percent fewer enforcement personnel than it did in 2010, and audit rates have fallen dramatically, potentially affecting enforcement revenue and, more concerning, voluntary compliance.

Third, the Federal tax system contains complex rules that may be necessary to achieve some tax policy goals, such as providing benefits to specific groups of taxpayers. However, this complexity also imposes a wide range of recordkeeping, planning, and filing requirements upon taxpayers. This complexity can lead to errors in underpaid taxes.

Complexity and the lack of transparency that it can create can also create doubts about the tax system's integrity.

GAO has made numerous recommendations to IRS to address these challenges, many of which have not yet been implemented. For example, IRS needs to develop a robust strategy outlining actions that it will take to maximize the data it collects, to update compliance programs and approaches, as well as the strategy to improve taxpayer service, to better assist compliant taxpayers trying to meet their tax filing responsibilities.

GAO has also identified several actions Congress can take to help address the tax gap. Key among these are requiring additional electronic filing of tax and information returns, which could help IRS improve compliance in a resource-efficient way.

Providing IRS with broader authority with appropriate safeguards to correct errors on tax returns could improve compliance, while reducing the burden on taxpayers.

And finally, giving the IRS the authority to regulate paid tax return preparers could improve the accuracy of the tax returns they prepare.

Chairman Neal, Ranking Member Brady, and members of the committee, this concludes my prepared remarks. I look forward to your questions.

[\[The statement of Mr. McTigue follows:\]](#)

\*Chairman Neal. Thank you, Mr. McTigue.

With that, Dr. Herndon, would you please begin.

BEN HERNDON, CHIEF RESEARCH AND ANALYTICS OFFICER, INTERNAL REVENUE SERVICE

\*Mr. Herndon. Chairman Neal, Ranking Member Brady, and members of the committee, my name is Dr. Benjamin Herndon. I am the IRS' Chief Research and Analytics Officer.

I appreciate the opportunity to testify today and discuss my office's work related to the methodology underlying the tax gap analysis and estimates.

Before joining the IRS in 2016, I spent 7 years as a research professor in the Business School at the Georgia Institute of Technology. My field of specialization is in cognitive and technical strategies.

I hold three advanced degrees from the University of Texas at Austin, including a Ph.D. in organization science.

In my role at the IRS, I direct the agency's Office of Research, Applied Analytics and Statistics, which is also called RAAS.

We support effective and efficient tax administration by providing strategic research, analytics, statistics, and insight to the IRS' business units to inform their decision making and increase innovation across the agency.

One of the functions of RAAS is to oversee the data collection and methodology the IRS uses to measure the tax gap. The tax gap is defined as the difference between the amount of tax owed by taxpayers for a given year and the amount that is actually paid voluntarily and timely.

The tax gap represents in dollar terms the annual amount of noncompliance with our tax laws.

The most recent IRS study of the tax gap was released in 2016, covering tax years 2008 through 2010. The study estimates the average annual gross tax gap for that period at \$458 billion, and the voluntary tax compliance rate at 81.7 percent.

The previous study covering tax year 2016 estimated the gross tax gap at \$450 billion and the voluntary compliance rate at 83.1 percent.

The IRS is in the process of preparing a new study on the tax gap covering tax years 2011 through 2013, and we expect this report to be released later this year.

The figure of \$458 billion that I referenced earlier does not account for the revenue brought in through enforcement activities, such as audits and document matching. After factoring in those activities, the average net tax gap for 2008 through 2010 is estimated to be \$406 billion per year.

When look at by mode of the compliance, the tax gap can be divided into three primary components:

- Non-filing, or not filing returns on time;

- Underreporting, or not reporting one's full tax liability when the return is filed;

- Or underpayment, not paying by the due date the full amount of tax reported on a timely filed return.

By far the largest component of the tax gap is underreporting, representing \$387 billion of the \$458 billion total. Individual underreporting comprises \$264 billion of that \$387 billion number, while employment tax represents \$81 billion; corporate tax, \$41 billion; and excise tax, \$1 billion.

The latest results confirm an important point about the tax gap. The compliance rate is very high for income that is subject to third-party information reporting and higher still when you also have withholding.

The 2016 study found that when there is information reporting, such as 1099s,

income is underreported only about 7 percent of the time. That number drops to 1 percent for income subject to both third-party reporting and withholding. But the number jumps to 63 percent for income not subject to any third-party reporting or withholding.

Chairman Neal, Ranking Member Brady, and members of the committee, that concludes my statement, and I look forward to your questions.

[\[The statement of Mr. Herndon follows:\]](#)

\*Chairman Neal. Thank you, Dr. Herndon.

And with that, let me recognize Mr. Wood.

STATEMENT OF KENNETH WOOD, FORMER IRS DEPUTY ASSOCIATE CHIEF  
COUNSEL, OFFICE OF CHIEF COUNSEL (INTERNATIONAL), INTERNAL  
REVENUE SERVICE

\*Mr. Wood. Chairman Neal, Ranking Member Brady, and members of the Ways and Means Committee, thank you for inviting me to discuss issues regarding enforcement and compliance in the international tax system.

The views expressed herein are my own and should not be attributed to any other source.

Very briefly, I practiced international tax for 34 years, both in the government and in private practice, with many years focused on transfer pricing.

From 2016 to 2018, I was the Deputy Associate Chief Counsel, International, in the Office of Chief Counsel, IRS, where I was responsible for transfer pricing and international programs. I retired in August of 2018.

The business world is very complex, involving legal, transactional, financial, and contractual complexity. To ensure that businesses properly report their income, Internal Revenue Code, regulations, and other guidance are, in turn, voluminous and very complex.

Over the last 30-plus years, transfer pricing has posed the greatest threat to the tax base. The relevant tax authority, Section 482 and the regulations thereunder, which basically set out the arm's length standard.

However, these rules cannot provide much more than a framework for evaluating prices charged for sales of goods, transfers of intangible property, provision of services, loans and advances, et cetera, between related parties.

The facts of each transaction are typically very complex. The economic analysis is difficult and not susceptible of precision, and the legal guidelines are somewhat blunt.

As a result, the task of auditing the pricing of trillions of dollars of transactions within the statute of limitations is an extraordinarily heavy lift. And as budgets shrink and senior personnel with substantial transfer pricing experience retire and cannot be replaced, transfer pricing audits become much more challenging, and tax revenues fall.

On the other side are large, well advised, multinational corporations that control the facts, but resist responding to legitimate IRS inquiries in a timely manner in the hope that they can run out the clock.

Given the tax dollars at risk, these taxpayers spend tens of millions of dollars annually on tax controversy. If you are curious, I suggest you review the financial statements of taxpayers that have recently litigated or are litigating a large transfer pricing case.

These expenditures support not just a substantive defense of their tax position, but also efforts to undermine the IRS' ability to develop its case. It is hardball litigation by counsel zealously representing their clients, and they have far larger budgets than the IRS.

Taxpayers are understandably willing to spend millions to save billions. While the IRS has excellent, very hardworking litigators, the organization has far fewer resources than taxpayers to devote to these cases.

I would like to share an example based on a recent Tax Court opinion that will give you an idea of what the IRS is up against.

A major U.S. multinational with a huge market share manufactures and sells high tech medical devices. It performs all of the research and development using senior scientists and engineers and owns all of the intangible property, patents, trademarks, et cetera.

It manufactures all the components to exacting specifications, obtains all of the regulatory approvals, and writes all of the imbedded software.



It then ships the components to a subsidiary in a low tax jurisdiction, and the subsidiary performs a straightforward assembly and testing operation, pursuant to instructions provided by the U.S. parent.

The subsidiary then ships the assembled product back to the U.S. parent where a sophisticated, experienced sales team takes the product to doctors and other health professionals for sale. The product is then implanted in human bodies.

The taxpayer in this case claimed on its income tax return that more than 60 percent of the total net income from all activities was attributable to the assembly and testing operations of the subsidiary.

It does not take a transfer pricing expert to know that most of the value of this product was derived from functions performed and assets employed by the U.S. parent.

Interestingly, more than 90 percent of the cost of the entire operation was incurred by the U.S. parent. That the taxpayer took an aggressive position was not surprising. What was surprising was that the Tax Court concluded that the taxpayer was largely correct.

Although the Court of Appeals reversed and remanded this opinion, it illustrates the challenges the IRS faces to achieve rational results.

There are no easy answers to resolve these challenges, but substantially increasing the IRS budget is necessary if the IRS is to prevail in large, complex cases.

Revisions to the Tax Court rules and practices would also help create a more level playing field. Average American taxpayers deserve at least that much.

Thank you.

[\[The statement of Mr. Wood follows:\]](#)

\*Chairman Neal. Thank you, Mr. Wood.

We will now proceed to questioning under the 5-minute rule. Consistent with committee practice, I will recognize those members present at the time the gavel came down in order of seniority, and I will begin by recognizing myself.

Inspector General George, how has technology allowed the IRS to enforce the tax laws and collect from those who do not pay?

\*Mr. George. The IRS makes extensive use of technology, Mr. Chairman, and it is something that is completely required, given the massive tax burden that the American people have and the obligation of the IRS to consider their returns and process them and issue refunds when appropriate on an expedited basis.

An example of the technology that they use includes the return review program, which allows them to review returns for mistakes and to ensure information that they have received independent of the taxpayer comports with the information that the taxpayer has provided.

A similar device or program is the automated underreported program that attempts to achieve the same goal, ensuring that the information that the IRS receives is accurate both in terms of the taxpayer as well as the supplier of third-party information.

That said, much more could be done. Again, as I stated in my opening statement, as well as in my written testimony, with these advancing economy tools, meaning the gig economy, and by gig economy, for those who are not very familiar, I mean, for example, Uber employees or contractors or Lyft and many others who are just not necessarily reporting all of the income that they received and the IRS not having information to the contrary.

So this is a tremendous opportunity for people to not comply with their tax obligation, and so if the IRS simply altered some of their programming to take into account

this gap and/or issued regulations, and this is where, again, I made reference to non-resource, meaning dollar, amount necessarily to ensure that new process could be put in place to require both information to those gig economy participants, namely, both the companies as well as the individuals who work for those companies.

More can be done.

\*Chairman Neal. Thank you. I heard it described last weekend as the contingent economy, and I thought that that was an apt description.

Let me follow up with you, Inspector General. Why is it important to audit high wealth taxpayers?

And what has happened to the IRS program for examining these taxpayers?

\*Mr. George. Well, as, and I hate to resort to this type of statement, but as Willie Sutton said, that is where the money is, and as it relates --

\*Chairman Neal. He came from Massachusetts, yeah.

[Laughter.]

\*Mr. George. Oh, I did not know that.

So the high-income taxpayers tend to have obviously additional money, more money owed, but very complicated tax returns.

So I know there is a concern that some lower income individuals receive audits in the form of correspondence, which is a more simplistic way for the IRS to address issues or just questions of noncompliance. That same method is not effective as it relates to people who have very complicated tax returns, namely, wealthy individuals.

So the IRS has to be able to provide resources other than a letter to a taxpayer as it relates to higher income returns.

\*Chairman Neal. Thank you.

You answered my next question. But, Dr. Herndon, the IRS is preparing a new tax

gap estimate to be released next month. What has changed since the last report?

\*Mr. Herndon. Thank you, Chairman.

Unfortunately, it would be premature for us to comment on what the new tax gap report tells us in contrast to the previous reports. We are still tabulating the data at the highest level and obviously are concerned about releasing any indication of where we think that might be headed when we have not had an opportunity to fully vet it internally.

So I appreciate the question. It is certainly something that is on all of our minds, and we will release that report as soon as we can.

\*Chairman Neal. And you believe that is next month?

\*Mr. Herndon. I believe it will be June or July, is my understanding.

\*Chairman Neal. And I hope you can get that to us almost at the time of publication.

\*Mr. Herndon. Certainly.

\*Chairman Neal. Thank you.

And Director McTigue, what needs to be done to get the tax gap off the GAO's high risk list?

\*Mr. McTigue. Chairman Neal, as you are aware, GAO uses five criteria to assess the progress in addressing high risk areas. The first criteria are leadership commitment and I should say we have assessed IRS is fully meeting that criteria.

Agency capacity is the second. An action plan is the third criteria. Monitoring efforts is the fourth, and demonstrated progress toward meeting the actions that they outline.

Over the years, GAO has talked about three pillars of the tax gap. The first we have talked a little bit about already, and that is enforcement. To the extent that IRS can go after noncompliant taxpayers, whether through audits, notices or through improved education,

that can help the tax gap.

The second pillar that we have talked about is taxpayer service, helping those who are trying to comply with their tax reporting filing requirements and obligations. To actually be able to do that is key to any success.

And we have long recommended that IRS develop a customer service strategy, a comprehensive service strategy that involves meeting the taxpayer in ways that they want to interact with the IRS, whether that is in person, online, on the telephone, or through correspondence.

To this date, IRS has not released a comprehensive customer service strategy. In 2015 or 2016, we actually had a matter before Congress to require the Treasury, in conjunction with working with the IRS Commissioner, to develop such a strategy.

The Congress passed a resolution requiring such a customer service strategy, and as I said, to this date IRS has not produced that strategy.

And finally, the third pillar that we have talked about is tax complexity. The easier it is for taxpayers to understand and report, they can be compliant. So to the extent that filing can be simplified, the tax law be simplified, we think that enhances voluntary compliance as well.

\*Chairman Neal. Thank you.

Let me recognize the ranking member, Mr. Brady.

\*Mr. Brady. Thank you, Chairman Neal. And thank you for calling this hearing.

The IRS may not be popular, but it has an awfully lot of good folks here. We know because they solve a lot of constituent problems for us.

I remember a day when I could not tell you what party the IRS Commissioner was because they were objective. They were in our offices twice a year. We were working together regardless of party on tax gap, on information technology, on customer service, all

those key areas of making sure our Nation's tax collector, administrator, is doing their job, and we are helping them do that.

I have made no bones about it. I was very disappointed in a series of acting Commissioners in the previous administration. I think John Koskinen did terrible damage to the credibility of this agency.

I think though always underneath there has been a core of professionals all the way down to the field agents and others though, wanting desperately to do an excellent job.

And so I have high hopes for Commissioner Reddig, and I hope we return to the day where with hearings like this, Chairman, and thank you for calling them, so we can simply work together to make the IRS work better and smarter.

So I want to talk about that for a moment. Mr. McTigue, the 2012 report by your agency found there was a lot of potential for the IRS to reduce the tax gap by making better use of its resources, in effect, in the enforcement program, for example, by decreasing field audits, increasing correspondence audits; shifting some moderate resource from lower wealth individuals to the higher wealth individuals.

And then a follow-up report from GAO recommended that IRS set goals for tax compliance and have that comprehensive strategy.

So is the IRS following those recommendations?

Which of those have they fully embraced?

Are there areas where they can make better use of its resources to close this gap?

\*Mr. McTigue. Representative Brady, you are correct. Our 2012 report did look at the various enforcement programs, different types of audits across different types of taxpayers, and what we did find was that by reallocating about \$100 million from audits with low yield or success rates to audits where noncompliance is greater, the IRS potentially could recoup close to a billion dollars.

So we thought that was a very high return on investment. IRS did agree with our recommendations and has been taking steps to implement that recommendation. They have been working diligently trying to estimate marginal cost and have made strides calculating marginal revenue.

So you need those two components, both the costs and the revenue, before you can come up with a good measure of marginal return on investment.

And the analysis that we did looked at average return on investment, but you know, to really refine the methodology, you have to take it to the next step.

IRS has made progress. They need to do a little bit more research to finish that analysis.

And that brings me to the point of, and Dr. Herndon can speak more eloquently about this, but the IRS' use of data over the years. GAO has made a number of recommendations that IRS needs to more fully leverage all of the data that they collect.

I mean, essentially IRS is a giant information processing organization. They have a lot of data. They use a lot of it, but there is even more value in the data that they collect, and that can improve understanding of compliance and noncompliance.

It can improve audit approaches, and it can also reduce the burden on compliant taxpayers by better targeting or selecting returns for audit.

\*Mr. Brady. All right. Thank you, sir.

And could you let the committee know by letter if there are any of those recommendations that were not implemented yet by the IRS that we need to be aware of so we can continue to follow up?

And, Mr. George, recently you recommended IRS improve the way it uses its resources and makes decisions by better monitoring audit closures in different compliance areas.

Did the IRS agree with those recommendations?

Have they implemented them?

\*Mr. George. They have agreed, and they are in the process of doing so, sir.

\*Mr. Brady. Good. Thank you.

Look. I think I just want to point out while there may be a lot of discussion today about increasing the IRS funding, you know, I believe the agency, while working forward, still needs to do a better job with the funding resources it currently has. And we are eager to continue to help them improve.

With that, I yield back.

\*Chairman Neal. Thank you, Mr. Brady.

Let me recognize the gentleman from Georgia to inquire. Mr. Lewis.

\*Mr. Lewis. Good morning and welcome.

Mr. Chairman, thank you for holding this hearing.

I would appreciate if each of you would expand upon your testimony on the importance of restoring funding, staff, and training in the IRS.

Starting with you, Mr. George.

\*Mr. George. Mr. Lewis, there is a factoid that I would like to share, and that is we have calculated that the 1,600 fewer revenue officers that the IRS has now, and this is actually a figure from 2010 to 2017.

They have 1,600 fewer revenue officers. We validated that each revenue officer is able to bring in roughly \$2 million each, which would result in over \$3 billion less revenue brought into the IRS as a result of the reduction in those revenue officers.

That is striking. So there is no question that if there were additional revenue officers, I know most Americans dread the notion of being audited, but as I pointed out in my oral and written testimony, that is the most effective way the IRS has to collect



revenue.

\*Mr. Lewis. Continue down the line, down the row.

\*Mr. McTigue. Congressman Lewis, I would comment that GAO issued a report this spring looking at strategic human capital management at IRS, and what we found was a little disturbing in that given the year after year of budget cuts since 2010, IRS has lost people in critical skills area, including the human capital function where highly skilled people do the studies to analyze and find, you know, where are the skills missing in the operation.

What skills will be needed in the future?

And because no hiring was going on, no training was going on, that function atrophied.

As the Inspector General just mentioned, the enforcement area suffered as well, and I would also add that the taxpayer service function suffered as well. Over the years, IRS has struggled to maintain an adequate level of service on phones to answer taxpayer questions.

On the enforcement side, audit rates are way down, and while it is hard to quantify any kind of estimates, enforcement revenue has been more or less constant over the last several years at about \$50 billion; IRS' budget at about 11 or \$12 billion.

That alone is a very positive ROI of four to \$5 for every dollar invested in IRS.

\*Mr. Lewis. Thank you.

\*Mr. Herndon. I know there are a number of figures regarding ROI from investment in the IRS. You know, while I cannot pin one down in particular, I can say undeniably that this is an organization that could do more with more resources.

In my particular organization, I see this in the area of attracting and retaining data and analytics talent, which you might know is probably one of the more sought after skill

sets in the private economy at this time.

And as we look forward to a service that hopefully takes greater advantage of data in its activities and operations, that will be a critical capability as we move forward.

Thank you.

\*Mr. Lewis. Thank you.

Mr. Wood.

\*Mr. Wood. Congressman Lewis, I cannot give you specific numbers with respect to the IRS' personnel involved in large case litigation.

I can certainly tell you that when they match up against the private sector typically in cases involving billions of dollars of proposed efficiencies, that the number of people employed by the taxpayer and used to build their own case and impede the government's case is far in excess of what the IRS can bring to the table.

If you look at the docket in the Tax Court, I think there are roughly 30,000 cases at any one time. That is the bulk of the tax litigation, and that is what the IRS Chief Counsel's Office is responsible for.

And including all that, then you have these massive cases which are hugely complicated, and you need big resources to match up against the other side, and they simply do not have them.

\*Mr. Lewis. Thank you.

Thank you, Mr. Chairman. I yield back.

\*Chairman Neal. Thank you, Mr. Lewis.

Let me recognize the gentleman from Nebraska, Mr. Smith, to inquire.

\*Mr. Smith of Nebraska. Thank you, Mr. Chairman. I appreciate this hearing opportunity today. It is certainly an important topic.

I know that as we sort out the various details and complexities of the tax code, I

hope that we can continue to simplify the tax code. We did that somewhat recently, but I think we need clear guidelines, for example, on how contractors, free lancers and others outside the traditional employer-employee relationship are treated by the tax code. This will improve compliance on both sides of these relationships.

At the same time, we should look back at mistakes which have been made in the past to inform ways in which we should not go about trying to supposedly improve compliance in some of these relationships.

One recent example stands out to me, and that was the vast expansion of the 1099 reporting requirements, which were included in the ACA. Under that expansion, businesses would have been required to provide a 1099 to every individual or business from whom they bought more than \$600 in goods or services.

Almost immediately I heard from businesses across my district about the massive new paperwork burden this would have created for them. One restaurateur from my district I spoke with would have gone from handful of 1099s each year to dozens upon dozens.

Carrying that forward to today's conversation, I can only imagine the difficulty someone wanting to participate in the gig economy would face if they had to start issuing 1099s to gas stations, tire stores, service stations, and their phone provider under this regulation.

Thankfully, we repealed that provision on a bipartisan basis.

What we really need are easy to follow rules under a simpler tax code which make it clearer how to comply and when people are not complying.

Mr. McTigue, your agency has long argued that one key component to reducing the tax gap is to improve the simplicity in administration of the tax code; essentially that if you reduce the burden on taxpayers, they are more likely to comply and pay what they owe.

Would you agree with that characterization?

\*Mr. McTigue. Yes, sir.

\*Mr. Smith of Nebraska. Thank you.

And I believe that GAO has long suggested that you can simplify the tax code and reduce the tax gap through fundamental tax reform; is that correct?

\*Mr. McTigue. That is correct.

\*Mr. Smith of Nebraska. Thank you.

We have made some good progress to that end in the Tax Cuts and Jobs Act. We nearly doubled the standard deduction, meaning a substantial number of taxpayers no longer needed to itemize their deductions.

We also reduced individual and corporate tax rates so there is less of an incentive for taxpayers to avoid paying punitive tax rates.

All these efforts to simplify the tax code also saved taxpayers hard earned money. According to the Tax Foundation, the changes we made to the tax code from the Tax Cuts and Jobs Act resulted in a compliance cost savings up to \$5.4 billion.

Mr. McTigue and Mr. George, would you agree that these steps simplified the tax code for taxpayers and overall should help them comply with the tax code?

\*Mr. George. Again, I missed that last part, sir.

\*Mr. Smith of Nebraska. Would you agree that the steps that we took, such as doubling the standard deduction and other steps, in the Tax Cuts and Jobs Act simplified the tax code for taxpayers and overall should help them in compliance?

\*Mr. George. Congressman, as Mr. McTigue noted and as you asserted in the preface of your question, there is no question making it simpler to comply with your tax obligations would ensure greater compliance on the part of the taxpayers. It is QED.

\*Mr. Smith of Nebraska. Very well. Thank you.

Mr. McTigue, anything you would like to add?

\*Mr. McTigue. I would agree as well. In particular, the doubling of the standard deduction is an excellent case of where the tax code was simplified and made filing easier for many taxpayers.

There are other provisions of the law that introduced new complexity, and I think the Congress and others are working on those areas as well.

The one thing I would also add, I actually see the gig economy as an opportunity to address the tax gap because what we have with the gig economy are platforms, that are digital information systems that are tracking payments. So that has the potential to reduce the burden on both the workers and the companies employing those workers and very easily provide that information to both the workers and the IRS to potentially increase compliance.

\*Mr. Smith of Nebraska. Thank you.

I yield the balance of my time to Mr. Brady.

\*Mr. Brady. So I want to follow up with Mr. Smith.

So, Mr. George, you said 1,600 more IRS agents would yield \$3 billion?

\*Mr. George. That is --

\*Mr. Brady. So if we unleash 1,600 more agents on the country, we reduce the tax gap by less than 1 percent?

\*Mr. George. Well, again, we used the number based on a formula, sir. So you have to assume. Assuming everything else remains the same, yes.

\*Mr. Brady. So yes. Thank you.

\*Chairman Neal. Thank you.

Let me recognize the gentleman from Texas to inquire, Mr. Doggett.

\*Mr. Doggett. Thank you.

Gentlemen, I very much appreciate your testimony, but I would say that the one instrument that would be the most helpful to this committee in understanding why this tax gap has not been addressed is a mirror.

This gigantic tax gap did not happen by accident. It is the direct result of the failures and the indifference of this committee over the last years, and sometimes its deliberate attempt to facilitate tax dodging.

We have gone through a period of time when the IRS has been held up as a failure, as a harm to the American economy, and the committee and its allies throughout this House have done their best to assure that the IRS lacked the resources to be a success.

The committee learned of the Panama Papers not through any of its work, but through excellent investigative journalism, and despite pleas that it respond and conduct its own investigation, it did absolutely nothing.

The committee learned and had requests for action following the Paradise Papers, another excellent investigative reporting about international tax dodging. It did absolutely nothing.

And in addition to the failure to investigate and fulfill its responsibilities, it has been told over and over again not that anything you said this morning, Mr. George, is really a surprise, that if would invest a dollar in enforcement, we get about \$3 back for the Treasury, not having to raise taxes on other people, but simply seeing that those who owe taxes pay their fair share.

But the committee largely ignored that testimony, and only this year in the Budget Committee, there were Republican efforts to undermine attempts to increase IRS enforcement to get the revenue that some people are dodging.

Of course, the tax gap is not helped when the most powerful person in the country and in the world tells Americans it is smart, to use his word, to not pay taxes. Indeed, only

this week President Trump declared after we learned that he was the biggest loser in America for many years when it came to what he showed on his tax returns, almost twice some years than the next largest loser, when his response was in a tweet this week, and I quote, "You always wanted to show losses for tax purposes. Almost all real estate developers did, and often to negotiate with banks it was sport."

It was sport. What words for the President of the United States when we want public confidence in our tax system to declare it is sport to underreport, to dodge your taxes.

Of course, this comes after a special reward that he and other real estate developers like this got through the good graces of this committee. Well, that may be a little bit of an overstatement. Actually this committee did not include a special provision for real estate promoter, nor did the Senate, nor did the House until the conference committee, and after the conference committee, a special Trump tax provision was added just as was the special provision to lower the tax rate for the most wealthy people in the country.

I want to ask, Mr. Chairman, to include in the record the new report from ProPublica, "The IRS tried to take on the ultra wealthy and it did not go well."

\*Mr. Thompson. [Presiding.] Hearing no objection, such will be the order.

[\[The information follows:\]](#)

\*Mr. Doggett. Mr. George, in 2009, the IRS created a unit called the Global High Wealth Group to audit taxpayers' worth over \$10 million. The current IRS Commissioner, Mr. Reddig, Mr. Trump's appointee, was at that time with a well-heeled law firm. He referred to the work of this group as "audits from hell."

Is it true, sir, that at this point the IRS has still not established the Global High Wealth Division as a stand-alone entity, and that it has been, quote, de-emphasized organizationally?

\*Mr. George. It is true, sir, that they have not yet established that.

\*Mr. Doggett. Thank you.

So after all of this time, something could have been done, but we have an IRS Commissioner in place who does not really believe in this.

And, Mr. Wood, you have described the machinations that these international corporations go through to avoid paying their fair share of our national security. As you know, I have legislation that simply says you do not have an incentive to go abroad because you pay the same tax rate there as you do here. It is part of the attempt to prevent the outsourcing of American jobs and profits.

If that were the law, would that reduce the incentive for these transfer of pricing games?

\*Mr. Wood. It would certainly reduce the incentive to do so.

I would say I think it is an open question as to whether the 2017 Act might also have reduced the incentive by currently taxing some offshore profits and also reducing the rate on the FDII income.

\*Mr. Doggett. And I certainly --

\*Mr. Wood. Time will tell, but certainly, eliminating deferral and taxing it at the full rate would certainly go a long way toward doing that.



\*Mr. Doggett. I agree with you on that, save the three loopholes that were created by the same Act.

Thank you.

\*Mr. Thomas. Mr. Marchant, do you wish to inquire?

\*Mr. Marchant. Thank you, Mr. Chairman.

As you can imagine, our offices get a lot of phone calls about the IRS, and they are usually not calling to help to reduce the tax gap. They are usually calling because they have not gotten their refund or they feel like they have been treated unfairly.

So my questions will be about customer service, and I do appreciate though, as a Congressman, the IRS' program where they have a liaison that our offices can call to help our constituents. It is very helpful to me and my district office.

Mr. McTigue, can you talk about the interaction between providing high quality customer service to taxpayers and how it affects voluntary compliance?

\*Mr. McTigue. Absolutely. As I mentioned in my oral statement, to the extent that IRS can help taxpayers wanting to pay their taxes understand the tax code, understand their filing requirements, and help them be compliant, we all win.

It is hard to quantify just how much of an impact that has, but we feel it is very important. It is important, you know, as technology is changing and expectations of customers are changing with new technologies and comfort with interacting with businesses and government agencies online that IRS focus on developing state-of-the-art online services to meet those taxpayers where they are comfortable, but not forgetting those who would like to walk into an office and talk to an agent or a customer service representative.

\*Mr. Marchant. We have missed that. Our constituents have missed the ability to walk into an office, by the way.

Do you think that the IRS has the proper information to set benchmarks?

And are they approaching their customer service programs the same way that a business would approach their customer service objectives?

Do you think that they have those tools?

\*Mr. McTigue. Right. You know, part of the impetus behind our recommendations over the years for IRS to develop a comprehensive customer service strategy, was to, you know, find out what taxpayers, what IRS' customers need and want from the IRS, and then to, you know, set appropriate measures and benchmarks so they could actually measure their performance in those areas and be evaluated against those measure.

IRS has taken some steps. We currently have work underway for this committee to look at the type of customer service measures that IRS employs, whether or not they're still appropriate and relevant to, as I mentioned, the changing technology and service channels.

So you know, they have taken some steps. We think more needs to be done in that area.

\*Mr. Marchant. Are you supportive of the provisions in the Taxpayer First Act for the IRS to develop that? I mean, you continue to tell them that they need to develop it.

\*Mr. McTigue. I am sorry. To develop the customer service strategy?

\*Mr. Marchant. In the Taxpayers First Act, yes.

\*Mr. McTigue. Absolutely, and as I mentioned earlier, the Congress actually required IRS two years ago to develop a comprehensive customer service strategy. It was in the 2017 Consolidated Appropriations Act, and IRS was given a 6-month deadline to develop that plan and submit it to the Appropriation Committees.

And to my knowledge that has not happened two years later.

\*Mr. Marchant. Just recently in response to the Tax Cuts and Jobs Act, Commissioner Reddig has testified that the IRS had adapted 500 forms and publications to

prepare for the 2019 filing season.

Of course, we will not know the result of that process for some time, but are you aware of those form changes?

And is it your opinion they will have a positive effect?

\*Mr. McTigue. We have not looked at that issue directly, to my knowledge. We did look at the filling season, and you know, with all of the changes that IRS needed to implement for this past filing season, and that coupled with the shutdown, IRS originally had a goal of about 80 percent level of service for answering telephones.

After the shutdown, they had to reduce that goal to about 65 percent, but they did achieve I think it was 67 percent level of service.

So you know, given the increased volume of questions from the new tax law, I think IRS managed the best they could.

\*Mr. Marchant. Thanks for your testimony.

\*Mr. Thompson. Thank you.

I will recognize myself for 5 minutes.

Thank you all for being here to testify before us.

I want to go back to an issue a couple of our colleagues talked about, and that is the underfunding of the IRS. It was noted that for every dollar that we invest in the IRS it results in \$4 in higher returns.

The numbers that we heard, the \$3 billion hole, was pretty impressive. And since 2010, IRS' funding has declined to the point where enforcement staff levels have decreased by nearly 40 percent.

Dr. Herndon, how has decreased funding for the IRS impacted its enforcement ability?

And what impact has that had on our tax gap?

\*Mr. Herndon. Thank you.

Obviously, decreased funding has reduced the ability to conduct a number of operations across the Service. You know, I have seen, obviously, a lot more evidence in my particular area of what the decrease in funding had created about the time that I came onboard.

You know, I could speculate as to what the impact had across the rest of the Service in terms of the operating units' abilities to conduct audits, update systems, to conduct the basic business of the Service, including customer service.

In terms of quantifying --

\*Mr. Thompson. Could you repeat that last? Could you repeat that last part again? Including?

\*Mr. Herndon. Customer service.

\*Mr. Thompson. Yes. Thank you.

\*Mr. Herndon. In terms of what impact those reductions in researches had on the tax gap would be a very complex and probably misleading connection to try to make.

For one thing, the tax gap, you know, is influenced by a lot of different numbers, a lot of different influences, some of them exogenous economic influences, some of them changes in obviously tax policy, tax code.

Certainly we can look at and the data, I believe, is publicly available to show over time how it has reduced the number of audits and, again, the number of activities in other IRS functions.

\*Mr. Thompson. Thank you.

Mr. McTigue, the GAO report on the shrinking IRS enforcement workforce says that it has resulted from years of decreased funding, retirements, and hiring freezes. How has decreased IRS enforcement staffing impacted audit effectiveness?

\*Mr. McTigue. Chairman Neal, I think we cited a lot of statistics, and I think the bottom line is across the board, audit rates have fallen not only for high wealth individuals, but those making more than \$200,000 a year just across the board, all categories.

We have made recommendations where IRS could increase efficiencies in regard to the audits that it undertakes looking at what return they get from looking at different types of tax returns for different types of taxpayers, and reallocate resources within the existing enforcement budget just to get, if you will, more bang for the buck.

But short of that, as others have pointed out, you know, you can only do so much with what you have. At some point if you do want to increase the audit rate, which has fallen dramatically since 2010, then perhaps it is time to consider additional resources.

IRS has achieved various efficiencies since 2010. I also pointed to fluctuations in customer service, the level of telephone service, and you know, just more broadly the level of service that they can provide to taxpayers to help them comply.

\*Mr. Thompson. Thank you very much.

Mr. Doggett had talked extensively about some of the issues regarding the President's tax behavior, and this week in an explosive newspaper article said the President had losses totaling over \$1 billion between 1985 and 1994, and here one of the self-described most richest people in the world did not pay any taxes during a number of those years.

Dr. Herndon, in light of these reports about the President's taxes and his finances, do you believe Americans have a fair tax system?

\*Mr. Herndon. That is a complex question, obviously, Mr. Chairman. You know, I will say that, you know, with regard to the recent claims, I have not seen data to be able to determine or assess the veracity for myself.

With regard to the fairness of the tax system overall, you know, I know it is a huge

priority for this Commissioner and this Service to maintain a tax system that is as fair as possible.

We certainly provide data to the operating units and to the Commissioner as well as tools to allow them and enable them to make much more dynamic and real time assessments of the impacts of their enforcement functions on the population, and that I am sure includes assessments of fairness.

For me to make a determination of fairness I think would require a much deeper examination of the data at hand.

\*Mr. Thompson. Thank you very much.

Mr. Kelly.

\*Mr. Kelly. Thank you, Chairman, and thanks for holding the hearing today.

And thank you all for being here.

One of the things that we have talked about and one of the things that we look at and say, "You know what? There are areas in the tax code that allow certain things to happen." And, you know, fixing this is an awful lot like talking about the weather versus we need to do something about the weather.

But really, nobody does anything about it. So one of the things I want to talk about, in fact, Representative Thompson and myself had legislation pending to address a particularly egregious tax shelter that's infecting our charitable conservation tax program.

Now, despite Treasury listing these transactions as abusive shelters in 2016, the promoters continue to organize, promote, and sell these deals. More than \$20 billion in unwarranted charitable deductions have been claimed to date.

The Department of Justice says in its injunction suit, which was filed in December, that the U.S. will suffer irreparable injury if the defendants are not stopped. They have not been stopped.

Any who have any opinions on that, of why can we not go after what we already know?

We know who they are. We know where they live. We know what they are doing, and yet we have not been able to do anything about it.

\*Mr. George. Congressman, obviously if it is permitted by the Internal Revenue Code, people can attempt to take advantage of any opportunity they can to reduce their tax obligation.

Again, the difference between tax evasion and tax avoidance, one is legal, one is not.

I can say to you that it has been brought to my attention that the IRS' Large Business and Internal Division does have a campaign ongoing to look at these conservation easements.

\*Mr. Kelly. General, let me ask you because I think the estimate was there is maybe a 20 percent recovery.

\*Mr. George. I am not certain of that figure, sir.

\*Mr. Kelly. Okay. All right. So I cannot imagine.

Coming from the private sector, if you are looking at accounts receivable and you know they are out there and you cannot get to them, I would suggest that getting 20 percent back on what is already owed to you is a little bit ominous.

So I keep looking at this stuff not from a standpoint of sitting here being an elected member of Congress, but sitting here as a taxpayer and wondering. So why is it? Why is it that there is this huge gap?

And I am wondering at some point because I have people come up to me, and I am with Mr. Marchant. I have never had anybody call me and ask me about, "Is it a possibility that I could maybe pay more taxes. I really am enjoying a lot of benefits."

Most of the people that call us are scared to death that they have made a mistake and may be going through some type of an audit. Is it more of a cultural problem with this? In some cases, they are just going to cheat no matter what happens. It is just part of their DNA.

There are other people that do not mind paying their taxes because they receive great benefits, and so I wonder about all this.

I know we are talking about all these different things that we can do, and we have even talked about, geez, if we just increased the budget to the IRS, it would do quite well, but just not these figures.

So in 2010, the largest appropriations to the IRS was \$12.1 billion. Six, point, six billion dollars went to an enforcement program, and the enforcement revenue collected was \$57.6 billion. Twelve, point, one billion total appropriation.

In 2018, okay, the appropriation was \$11.4 billion. So if I look back and I look at the return on that investment by hardworking American taxpayers, because that is who picks up the tab on everything, right, so back in 2010, do you know what the return was? About a little bit over or almost \$9 per dollar that was appropriated. That was on the 12.1 billion.

In 2018, with \$11.4 billion totally appropriated to it, we got back almost \$11. So we spent less money and got a higher return on it.

I just think that sometimes we worry so much and say if we just threw more money at it, we would be okay. I think the real answer is if we just improve the process, and if we could somehow make taxpayers feel that it is not just an obligation. It is a responsibility to fund this incredible government that we have.

But do you know what people tell me all the time? "I do not mind paying my taxes if they just did not waste so much money that I send them."



So I think it is a complicated issue. I do not know that we can solve it here, but I do know this. Because of the Tax Cuts and Jobs Act, we are seeing unprecedented growth in our economy. We are seeing an unprecedented opportunity across our country right now.

So I think if we can keep our eye on what it is that really produces revenue, and it is corporations that are profitable. They only pay taxes on profits, and working people. The rest of it is in fines and fees and borrowing.

So I would much rather see it come from people who are having great years as opposed to those that are being put under duress.

Listen. I want to thank you all for what you do because I do not think you are in this for any other reason. You could make much more money in the private sector. I think you do it because of love of country and because you are patriotic. So thank you so much for coming here today.

\*Mr. Thompson. Thank you.

Mr. Blumenauer.

\*Mr. Blumenauer. Thank you, Mr. Chairman.

Let me begin by saying I identify very much with the comments from my friend, Mr. Doggett, and I heard Mr. Brady say that this has been a problem for decades, and it has.

But I think any American who just reads the testimony here before us has a sense of what the problem is.

I want to digress for one moment, and I am sorry the chairman is not here, but I was really offended by his cheap shot at John Koskinen.

For any of the members of the committee who did not have the privilege of working with John, Google him and you will find in his resume nine different items that would represent a career of anybody on this dais.

I have never heard his integrity impugned. He has been recruited by administrations, both Republican and Democrat, and he walked away from a private sector business that would have made him a billionaire, and instead he devoted his life to public service.

And I just found it offensive not just today, but before having people impugn his character.

Get to know the man. That is one of the reasons we have the problem. We are just in Never Never Land here. The IRS has had its capacity to do its job attacked -- there is no other way to say it -- in the last eight years by the Republicans.

Mr. Marchant said, well, it ought to be run like any other business. Absolutely. No business in America cuts its accounts receivable. They would go out and collect the bills that are due them.

And the budget numbers we are given understate the challenge that they face because in that period of time when we reduced over 20 percent of the people who work for the IRS, and we have documented that they have a computer system that goes back to when we were in college.

They have been challenged not just by a tax code that is infinitely more complex, including the Republican gift with their last tax bill, which is a nightmare for them, and there are more people in this country, millions of more returns, more complexity, fewer people, and we have given up on enforcement.

Now people do not like to be audited, but I meet regularly with people in my district who are tax professionals, lawyers, accountants, financial planners who wonder why the IRS does not audit anymore, and they are very candid that if you are not audited, it is easier to overlook income or to give yourself the benefit of the doubt for what you report.

Mr. Wood pointed out that for international businesses, it makes sense to invest

millions of dollars to avoid paying billions of dollars. And companies like General Electric for years had the finest tax law department in the country. They hired some of the all-stars away from the IRS or SEC.

And when they challenge a tax matter, it was taking a squirt gun to somebody who has got a battleship. And it is no wonder they wore them down and they win and the IRS often has to make compromises because they cannot keep pace with what they are up against.

And Congress and specifically, I am sad to say, my Republican colleagues made it worse. They have created two classes of taxpayers in this country.

Anybody who could afford a lawyer, a CPA or a lobbyist was able in many cases to be able to characterize their income differently and, by the way, pay less tax than people who were not so armed on similar amounts of money.

And poor people, actually the bottom 90 percent, the IRS knows about them because they have to report all of their income. The IRS has it, higher level of complexity. Not so with people with more money who can forget.

I think we ought to be serious about equipping the IRS to do its job. That is \$5 trillion over the next 10 years that is available for public purposes.

\*Mr. Thompson. The gentleman's time has expired.

Mr. Schweikert.

\*Mr. Schweikert. Thank you, Mr. Chairman.

Okay. Now actually let's try to come up with some ideas of what we could do policy-wise, what we could do technology-wise that actually would help.

What could we actually do creatively?

Mr. George, you actually touched on something about like in tip reporting, a mechanism. What was the 10 percent number?

\*Mr. George. Let me make sure I give you a precise answer.

\*Mr. Schweikert. Well, I will give you a moment to look that up.

\*Mr. George. Yes.

\*Mr. Schweikert. Can I walk through just a concept? And this is for Republicans and Democrats to think through. It is probably time we have an honest discussion about a distributive economy model, gig economy, whatever the latest title you want to give to it.

Should we allow on a voluntary basis, if that is how you have to get there, an employer saying, "You are a Lyft driver. Would you like us to withhold for you?"

Would that have a substantial impact on compliance?

Mr. George.

\*Mr. George. Yes, so first of all, the 10 percent was the amount of underreported income, which we equate to be about \$38 billion, tip money alone.

\*Mr. Schweikert. Okay.

\*Mr. George. And --

\*Mr. Schweikert. No, go. I will let you finish.

\*Mr. George. And as it relates to the gig economy, Uber and what have you, the one thing that Congress could definitely give and require is more information, and so this ties into --

\*Mr. Schweikert. But right now most of these companies that would do any type of this sort of model are terrified of if I give information, have I just moved into an employer-employee relationship instead of independent contractor.

\*Mr. George. That is correct.

\*Mr. Schweikert. Should we actually do an update there, and particularly with technology today. I know in a previous life a real estate office, where your agents are independent contractors, but it would be pretty darn easy to say, "Yes, I would like you to

withhold for me."

Particularly at that point it is a 1099-K, depending on because you might be paying quarterlies, but that is a simple policy change we could make here.

Now, we have to deal with all the folks who try to use the independent contractor/employee relationship as leverage and a wedge, but if we want compliance.

\*Mr. George. Well, Congressman, to quote a figure that was provided by a previous witness bears repeating because it is so stark, and again, it is there is such a high correlation between tax compliance and third-party information reporting or withholding.

When there is information reporting and withholding, as was noted, at the source, tax compliance is approximately 99 percent. Where there is --

\*Mr. Schweikert. Say that last sentence so everyone hears that again. Say that last sentence again.

\*Mr. George. When there is information reporting and withholding at the source, tax compliance is approximately 99 percent.

\*Mr. Schweikert. So for everyone here, if compliance is actually something that is our goal, we are going to have to do something that is a little uncomfortable for all of us and have an honest conversation of is it time to modernize the services that can be provide in an independent contractor relationship?

Just information, it is information, and maybe a voluntary withholding. I just found you billions of dollars and you made people's lives easier.

In my last minute I want to give you just a concept, and I know you have very smart people. A couple of years ago I sat down at a terminal of a company that is consumer data, and they let me log in. I had to sign all sorts of disclosures. They knew what type of ice cream I eat because of the data.

There is a stunning amount of commercially available data that they had the

prediction of my income down to within hundreds of dollars because of the data.

The reality of it is if we would allow the IRS to do much more of that type of data mining, it is not about an FTE count of employees. It is about technology and the access to that type of information to finding compliance.

And we have talked about this for tightening up the time frame for those that get an earned income tax credit. You can get rid of the delay mechanism if you would let us bounce the data off, that hey, consumption looks like it matches the income, and send them their negative income tax.

But you could actually move that up the income threshold of data mining. There is a world out there that if we are ready to deal with the technology and deal with the modern economy, I think we can actually have a real impact on just taxpayer compliance.

And with that I yield back, Mr. Chairman.

\*Chairman Neal. [Presiding] I thank the gentleman.

With that, we will now proceed based on precedent to a two-for-one recognition in terms of the order in which members took their seats. So we will proceed with Mr. Kind from Wisconsin to inquire.

\*Mr. Kind. Thank you, Mr. Chairman.

Mr. McTigue, let me start with you. This is a statement because we are looking for some help right now. I have been informed by some constituents back home that we have a malware problem with CCH software making it hard for various organizations to file on time.

Could you go back and direct whoever is in charge to see if that is getting fixed and maybe issue some guidance for these organizations, and if it is going to take longer, consider an extension of the timeline so that we do not have this problem?

We can get you some more information on that, Mr. McTigue, if you want.

\*Mr. McTigue. We would be happy to work with you on that. Thank you.

\*Mr. Kind. Thanks.

It just came to my attention in the last 24 hours or so.

And let me just stay with you again. A few years back, we had this problem with 501(c)(4) examinations, especially organizations that were involved almost exclusively in political operations. Mr. George knows it well. He conducted the investigation.

My question for you today is: is the IRS now in such a submissive position that there is no examination, no audits taking place with 501(c)(4) tax-exempt organizations, which by statute you may be reminded have to be operating exclusively for the promotion of social welfare?

But IRS regs now have changed that to primarily, which connotes a 51 percent or whatever. But can you tell us if the IRS is still looking at (c)(4)s to make sure that they are complying with the requirements of tax-exempt status?

It is directed to you, Mr. McTigue, yes.

\*Mr. McTigue. I am sorry. I thought it was directed to someone else here.

IRS continues to audit across the board individuals as well as 401(c) organizations. Audit rates have fallen. We did do a body of work. We issued about seven reports looking specifically at how IRS selects organizations, taxpayers for audit.

There was concern about whether or not certain groups were being targeted, whether or not selection was being conducted in a fair way across taxpayers.

\*Mr. Kind. Yes, there is no question we want a fair and balanced review. I do not care about political affiliation. I just want to make sure that the (c)(4)s are not just being ignored now because of the chill effect that went on with the previous.

Mr. George, you are kind of nodding your head that the IRS is doing the right thing here?

\*Mr. George. They are. They have, again, as he pointed out, not as I would use the word "aggressively" doing it, but they are still doing it.

\*Mr. Kind. Yes. Let me stay with you for a second because you mentioned in your testimony about the gig economy. Right now you used Uber as an example.

Would the issuance of 1099s not solve a lot of the underreporting problems?

\*Mr. George. The short answer is yes, but again, as it stands now, the IRS regulations only require people who earn \$20,000 per year or more and have 200 or so rough engagements, and I would have to do a little more research to define what an engagement is.

That is not the actual --

\*Mr. Kind. Was that a recommendation that you are making to the committee, that we ought to be taking a closer look at that and see how we can try and close that tax gap that has developed?

\*Mr. George. Most definitely, among others, yes.

\*Mr. Kind. Okay. Good. Mr. Wood, let me bring to your attention. You are probably aware, as most of us are, about the recent New York Times article that was dated May 8, 2019, titled "Decade in Red, Trump Tax Figures Show Over \$1 Billion in Business Losses."

Now, as a former IRS agent, someone with substantial experience in examinations and audits, if you encounter a multiple entity organization like this that is racking up all of these business losses, are there any particular red flags or concerns that you might have going into an examination process that you are going to be on the lookout for as to why we have such an unprecedented level of business losses and, therefore, no tax liability as a consequence?

You have to speak right into the mike.



\*Mr. Wood. Let me clarify. I was never an IRS agent. I was a national office tax attorney, but I have worked primarily on large corporate issues.

It is pretty clear that if you want to collect, you know, the most taxes, there are people to go after, the high net worth and large corporations. I am not sure exactly what you are looking for in terms of a response here.

\*Mr. Kind. Well, I am not trying to give you an answer, but I am just wondering with your experience and examinations and audits, when you see huge losses like this piling up, are there any particular red flags that you are going to be on the lookout for to kind of justify these losses?

\*Mr. Wood. Well, I mean, there are lots of reasons. People say a corporation did not pay taxes this year. They lost a lot of money. They may not pay taxes the next year because they are carrying over their losses from the prior year. That happens all the time.

\*Mr. Kind. Yes.

\*Mr. Wood. There are certainly a lot of red flags.

\*Mr. Kind. Do you think we have a problem with the certain preferences that are given in the code that relate to real estate developers, in particular, that we have to look at?

\*Mr. Wood. Yes, sure, there are.

\*Mr. Kind. Okay.

\*Mr. Wood. I guess I would start with taking a look at the Internal Revenue Code. I was looking at the number of pages this morning, and the Thomson Reuters version is more than 4,000 pages. The regulations are four or five times that.

\*Mr. Kind. Yes.

\*Mr. Wood. This is a massively complex creation of the Congress, and then you say, okay, figure it out.

\*Mr. Kind. Yes.

\*Mr. Wood. And unfortunately there --

\*Mr. Kind. Mr. Chairman, I would ask unanimous consent to have the article inserted in the record at this time.

\*Chairman Neal. So ordered.

[The information follows:]

\*\*\*\*\*COMMITTEE INSERT\*\*\*\*\*

\*Mr. Kind. Thank you.

I appreciate your response. Thank you.

\*Chairman Neal. I thank the witness.

The gentleman from New Jersey, Mr. Pascrell, is recognized to inquire.

\*Mr. Pascrell. Thank you, Mr. Chairman.

Mr. Wood, I have questions to open up with you, and if you will make your answers brief, I think we would all appreciate it. Thank you.

Thank you for your service.

Mr. Wood, if I take out a loan from a bank and I do not count the loan as income and pay taxes on it, correct?

\*Mr. Wood. Yes.

\*Mr. Pascrell. If I default on the loan -- I think you know where we are going here -- if I default on the loan and never repay it, is that discharged debt?

That is what it is called, discharged debt, correct?

\*Mr. Wood. Cancellation of indebtedness.

\*Mr. Pascrell. Is that considered taxable income?

\*Mr. Wood. Sure.

\*Mr. Pascrell. That is right. So would it be lawful to deduct the losses from a loan on your taxes and not report the income from the discharged debt?

\*Mr. Wood. Of course not.

\*Mr. Pascrell. Thank you, Mr. Wood. Your answers were very brief.

Now, because the wealthy and the powerful have teams of lawyers and accountants to help them find tricks and loopholes to lower their tax bills, and with the IRS continually underfunded and lacking resources, it gives wealthy tax cheats a green light to avoid paying their fair share.

In this report, it is reported that President Trump lost over \$1 billion, as the gentleman from Wisconsin pointed out, between 1985 and 1994, losses that came from borrowed money that he never paid taxes on. Yet that is the law.

You are not above the law, Mr. Wood. I am not above the law. Name some people that are above the law in the United States. No one.

So he deducted these losses through borrowed money and never reported the money he did not pay back in default. So this means that he may not have paid taxes he owed.

I say he may not have paid taxes he owed. He may have artificially inflated losses as his own to shield himself from taxation for years, possibly decades.

Now, you and I cannot conjecture about this. I cannot conjecture about this. I would like to know the facts to see what did happen, and that is what this is all about, Mr. Wood.

If this information is correct and Mr. Trump may have avoided paying income taxes on hundreds of millions of dollars in unreported income, I will tell you something, my own thought, if I could say something politically here.

Mr. Trump's base is going to be very angry when they find out that, yes, they probably have been had and so have a lot of Americans been had because we are paying our fair share and some other people are not.

So when someone, Mr. Wood, does not pay their property taxes in Patterson, New Jersey where I lived all my life, I have to pay more taxes. Do you know why I have to pay more taxes? Because the bills do not decline because I am not paying my fair share.

Paying your fair share is an American thing. It is a good thing, and we have no idea whether the IRS ever audited or challenged Mr. Trump on it. We have no idea. We have conjecture.

This committee, I believe, has taken steps to use our authority to obtain the

President's tax return and determine if the IRS is auditing him.

Mr. Trump and his Treasury Secretary are stonewalling us, defying the Congress of the United States, the Article I branch of government.

Does Mr. Trump want to keep his taxes hidden to keep us from closing the very loopholes he has used for decades to avoid paying taxes?

Why on earth would my brothers and sisters on the other side of the aisle choose to turn a blind eye and continue to shield the President?

Because some day somebody is going to say, "What did you do when we were looking into this? Did you stand up or did you cower behind the desk?"

Voters in my district do not get to choose when and how they pay taxes. I do not know about where you live, Mr. Wood.

\*Mr. Wood. I was born in Paterson. So --

[Laughter.]

\*Mr. Wood. I have not been there in a while.

\*Mr. Pascrell. With one T.

\*Mr. Kind. All of your previous testimony is now excluded from the record.

[Laughter.]

\*Chairman Neal. I thank the gentleman.

\*Mr. Pascrell. I hope that is not counted. Can I just finish my comments?

\*Chairman Neal. If it is not about Paterson, yes.

\*Mr. Pascrell. So neither should our Chief Executive or anyone else. We cannot sanction two sets of laws for the powerful and for the rest of us. We need one set of laws, and that is what this is about. That is the bottom line.

\*Chairman Neal. I thank the gentleman for his inquiry.

And let me recognize the gentelady from Indiana, Ms. Walorski, to inquire.

\*Ms. Walorski. Thank you, Mr. Chairman.

And thanks to our witnesses as well.

We held an oversight subcommittee hearing about a year and a half ago called the "Taxpayer Experience." At that hearing, I highlighted the story of an 80-year-old farmer in my district. He received a letter from the IRS saying that even though they had not found anything wrong, that he was subject to an audit, random, statistical audit.

The audit only took a few days, but this couple had to spend \$1,900 defending themselves, countless hours pulling together documents, and traveling to their CPA's office to meet with the IRS auditor.

All the while, they felt the burden was on them to prove their innocence instead of the auditor to prove any guilt.

Now we hear the GAO raise concerns in another report about the IRS' timeliness in using the data collected through its national research program, which includes statistical audits like the one that my constituent completed.

It is incredibly concerning that the IRS would cause so much havoc in the lives of innocent Americans in the name of research only to let that research collect dust. It is yet another example of the problem of bureaucracy running amuck.

Mr. Herndon, does your division currently have a comprehensive strategy for sharing all that data that is collected from the National Research Program audits so it can actually be helpful to IRS examination divisions?

If not, are you currently working on a plan or a strategy in response to GAO's recommendation?

\*Mr. Herndon. Certainly, thank you.

A couple of parts to my response. The first would be that we are always mindful of the burden that any audit, including NRP audits, places on taxpayers. It is certainly front of

mind for all of us.

We work very hard to apply that data to the techniques and tools that we develop in my organization. We use that data on a dynamic basis to update statistical models which we believe net-net reduce the burden on taxpayers by reducing the likelihood of false positive audits.

So our hope is that overall, we are doing the best that we can to select the right audits and to reduce the burden on taxpayers who are and are trying to be compliant.

Unfortunately, the only way for us to collect the data that we need to conduct those types of statistical analyses is through a random sampling technique, which the NRP employs.

That being said, you know, we are with every iteration attempting to revise our procedures to not only reduce the burden on taxpayers, but to reduce the total number that we need from the sample to accomplish our objectives.

So I very much understand the nature of your question, and please rest assured that it is very much a strategic priority for us.

\*Ms. Walorski. So you are currently working on a plan or a strategy in response to the GAO's recommendation?

\*Mr. Herndon. Yes, we are.

\*Ms. Walorski. Do you have any kind of a time estimate of when that would be complete?

\*Mr. Herndon. I believe later this year. I do not have a specific time estimate. Some of our deliverables have slipped with the shutdown, but we are actively working on a plan to coordinate those data assets more effectively with the operating units.

\*Ms. Walorski. Mr. George, I would like to get your views because the last time we got an update on the tax gap was April 2016, and we may be getting an update next

month. Do you think it is possible for the IRS to give us more frequent or interim updates, which TIGTA recommended in 2013?

\*Mr. George. It is difficult for them to do so. The process does take too long, Congresswoman. It really does.

Again, it has been over 10 years. It is not limited, in fairness to the IRS, to just this Nation. The International Monetary Fund recently issued a report on the tax gap in the European Union. It, too, relies on dated information. It just takes quite a while to collect this.

\*Ms. Walorski. And, in closing, Mr. Herndon, if it is really necessary to subject random taxpayers to audit, I would just ask that you remember the power the IRS yields over American taxpayers. Consider the fear that the word "audit" strikes in the hearts of taxpayers, even though they know they have done nothing wrong.

Think of the 80-year-old farmer in my district, and if you are going to put Americans through this process, the information better be put to good use to improve your operations because if you are putting these poor people through this, you can be sure you will be hearing from us again.

And in reference to another comment as we have been sitting here today, we do get a lot of phone calls from a lot of law abiding, tax paying, hardworking Americans. So I would just ask that if we are going through this process, let's use the information and make it worth that process.

Thank you, Mr. Chairman.

\*Mr. Herndon. I could not agree more. Thank you.

\*Ms. Walorski. I yield back.

\*Chairman Neal. We thank the gentlelady.

And with that, let me recognize the gentleman from Illinois to inquire. Mr. Davis.



\*Mr. Davis. Thank you, Mr. Chairman.

And I also want to thank our witnesses.

I am concerned by the fact that the Internal Revenue Service fraud filters seem hyper focused on tax credits that help working taxpayers like those used in the earned income tax credits and the CTC and are less focused on benefits taken by higher income earners.

In addition, these have extremely high false positive rates of about 80 percent.

So, Mr. Chairman, I ask unanimous consent to submit for the record this ProPublica article that documents these patterns of audits being over-focused on poor areas.

\*Chairman Neal. So ordered.

[\[The information follows:\]](#)

\*Mr. Davis. In particular, the study found that the counties with the highest rate of audits were all predominantly African American rural counties in the deep South. It seems like the system is not focused on taxpayer burden or higher level earners.

For example, it seems reasonable to include matching variables for K-1s or foreign bank account reporting in order to examine underpayment by wealthier taxpayers rather than simply burdening the poor with an 80 percent false positive rate.

Director McTigue, could you tell us why there is a high rate of false positives and what can be done to improve the filters so that even wealthier taxpayers pay what they owe?

\*Mr. McTigue. Congressman, I will defer to Dr. Herndon for more specifics in terms of the false positives, given the research that he has conducted.

However, I would say that this dovetails with the issue that we have been discussing quite a bit today, and that is the prevalence or lack thereof of information reporting on income, business income and income sources of higher earnings of individuals.

So IRS has less information to feed into their systems, their models, their filters to the tech noncompliance at that level. And you are correct that according to IRS statistics, those who are receiving an earned income tax credit are over four times more likely to be audited than those who do not.

So there is a discrepancy there of it is important to have audit coverage across the board to ensure that all taxpayers, number one, are being treated fairly and are, you know, fulfilling their tax obligation.

\*Mr. Davis. Dr. Herndon, could you respond to that?

\*Mr. Herndon. Certainly. First of all, I cannot really confirm or deny the statistics other than to say that I do not know where the number of an 80 percent false positives in the EITC audit would have come from.

In general, our false positives in the audit universe are extremely low. That being said, the data that we revise, as my colleague commented on, and the filters that we update on a regular basis are provided to the business operating units as an input into how they determine their overall exam plans.

So there are a number of other factors that the business units take into consideration in a very complex and dynamic constellation of priorities that they have to balance, and it would be inappropriate for me to comment on how they made that kind of --

\*Mr. Davis. Thank you very much.

I am reading from this ProPublica article that says Humphrey County, Mississippi. It seems like an odd place for the Internal Revenue Service to go hunting for tax cheats.

It is a rural county in the Mississippi Delta, known for its catfish farms, and more than a third of its mostly African American residents are below the poverty line. But according to a new study, it is the most heavily audited county in America.

Inspector George, have you seen any information or data that would suggest --

\*Mr. George. With the limited time that I have, I just want to make three quick points, sir. The most EITC audits that the IRS conducts are in States with the highest number of claimants, and those tend to be, of course, large population States, California, Texas, Florida, New York, and Illinois.

We at TIGTA are in the process of reviewing the selection criteria and filters that are used by the IRS as part of our overall filing season audit, but as for the States that you cited in your question, Mississippi does have the highest percentage of EIT claims in terms of the percentage of the population, but it is not the highest number of actual claims though.

\*Mr. Davis. Thank you.

Mr. Chairman, so there may be a better way of doing that.

\*Mr. George. Yes.

\*Mr. Davis. Thank you, and I yield back.

\*Chairman Neal. I thank the gentleman.

Let me recognize the gentlelady from Washington State, Ms. DelBene to inquire.

\*Ms. DelBene. Thank you, Mr. Chairman.

First, I would like to start and ask for unanimous consent to introduce into the record a report from the Center on Budget and Policy Priorities regarding funding for IRS enforcement.

\*Chairman Neal. So ordered.

[The information follows:]

\*\*\*\*\*COMMITTEE INSERT\*\*\*\*\*

\*Ms. DelBene. Thank you.

And following up on that, Inspector General George, the IRS's funding has declined and enforcement staffing levels have decreased by nearly 40 percent since 2010. You talked about this a little bit.

To what extent has that decline in funding and staffing affected the IRS' enforcement efforts, and can you talk about how you think about how we should allocate increased funding effectively in order to decrease the tax gap?

\*Mr. George. Congresswoman, I hate getting used to something along these lines, but it is almost a zero sum game. So if they have less money that they can use for enforcement, if tax law changes, require more attention to the 800 telephone number to make sure that people who call in with questions on how to file their taxes as a result of those tax law changes, the resources come from a different pot within the IRS.

So there is less money for enforcement officials and what have you. A very interesting factoid is that the highest amount of revenue that was paid in 2007, it was \$57 billion. It has gone down since then, \$57 billion because of lack of resources and having to make those tough choices.

\*Ms. DelBene. Thank you.

I also wanted to cover a little bit you brought up earlier, tip compliance and that tips were one of the areas where you saw a big tax gap. Since the IRS' enforcement in this area is limited, to what extent should we consider innovative ideas and incentives to make sure that we voluntarily encourage better tip reporting?

\*Mr. George. Well, this is one of those areas though where additional money is not necessarily needed because what is happening is that the IRS employees assigned to this area are being used in a way that does not necessarily bring in more revenue.

They are right now more concerned about the agreements that these particular

entities, restaurants, have to provide information and to deduct amounts to the IRS as opposed to actually going in to see if those amounts are accurate and if the relevant amounts of money are being produced.

So it is not that they need more money and more people necessarily. They need to reprioritize their actions.

\*Ms. DelBene. Are these the TRAC agreements that you are talking about?

\*Mr. George. These are the agreements, yes.

\*Ms. DelBene. The tip reporting alternative commitment agreements?

\*Mr. George. That is correct.

\*Ms. DelBene. So if tip reporting can be improved by just 10 percent, I have a number here. More than \$23 billion would be collected over 10 years; is that correct?

\*Mr. George. Yes, assuming everything were to work out the way it is envisioned, yes, but who knows what would happen? It could be more; it could be less.

\*Ms. DelBene. But so any incremental improvement that we would have in addressing it could actually have a significant impact on revenue and on the tax gap then?

\*Mr. George. Any favorable addressing of this both by Congress as well as by the IRS would result in more resources.

\*Ms. DelBene. Do others have feedback or comments on tip reporting or what we can do there?

\*Mr. McTigue. Yes, Congresswoman. I would just add two things.

First of all, we talked a little bit about 1099-K reporting, credit card payments, third-party settlement companies, and I know IRS has been looking at the information that has been collected in the 1099-Ks to come up with predictive models to help identify where noncompliance may occur, tip income being one of those areas.

The second point that I would make is this is an area where I would underscore the

need for Congress to provide IRS with the authority to regulate paid tax preparers. We did an undercover study back in 2014, and tipping income, cash income was one of the areas that often went underreported.

And what we found is many of the tax preparers were encouraging innocent or willing taxpayers to understate their cash income. You know, we heard various stories that IRS would never catch you or it will get your employer in trouble.

So we very strongly feel that paid tax preparers need additional education, competency testing. In States that have such regulations, such as Oregon, tax returns are something like 72 percent more likely to be correct than across the board.

So we feel strongly in that area that we think that could make a difference.

\*Ms. DelBene. Thank you.

My time has expired. I yield back.

\*Chairman Neal. I thank the gentlelady.

Let me recognize the gentleman from South Carolina, Mr. Rice, to inquire.

\*Mr. Rice. I have a bill that deals with tax reporting in the gig economy and that would, I think, assist in tax administration, and I wanted to talk about that.

But after some of the comments by Mr. Pascrell and others, I felt like I had to comment briefly on this committee's request for the President's tax returns.

You know, it is true that this committee strictly under the statute has the power to ask for an individual's tax return, and I was just asking the staff earlier whether or not they can recall this committee ever asking for an individual's tax return and they cannot.

You know, this power is granted to allow us to make sure the tax code is being administered properly, and to use this as a weapon against a political foe is gross abuse of that power.

I think that if we are going to use this power this way, we need to go one of two

ways. We should either move to strike this power from the code if we are unable to restrain ourselves from abusing it or we should just go ahead and adopt a procedure that any time we have a political foe that disagrees with us, we need to just go ahead and ask for their tax returns so we can scour them to find embarrassing information.

You know, this Mueller commission has scoured the President's financial information, including his tax returns, for the last two years. Nineteen lawyers did it, and they did not find any crime.

And here we are going to take it on ourselves because we disagree with the President as a politician, and we are going to ask for his tax returns so that for no other reason other than we are going to scour them to try to find politically damaging information.

I think this is a gross abuse of authority, and I think that I am embarrassed that this committee would do that.

Now, moving on to my proposal for this gig economy, Mr. George, you said that in a case where the income is reported, you have 90 percent compliance, correct?

\*Mr. George. Yes, 99 percent when it is both withheld at the source and reported to the IRS. It is 99 percent.

\*Mr. Rice. And then as a tax lawyer and a CPA practicing for 25 years, I often had the problem of, not often but on occasion, several times in my career, I had a client come to me, and the IRS, after they had been treating people as independent contractors for decades, the IRS came in and reclassified these people.

And that they had gone back for 10 years and assessed liability and penalties and interest, and the amount of the liability that they handed these taxpayers a bill for was enough to put them out of business.

I mean, they simply could not pay the liability that was presented to them.



Mr. Wood, can you characterize for me the test that the IRS uses to determine somebody who is an independent contractor for an employee? Are you familiar with that test?

Is it Mr. Hood?

\*Mr. Wood. No, it is Mr. Wood, and, no, I am not familiar with any of that.

\*Mr. Rice. Is anybody on the dais familiar with the test the IRS uses?

Well, I can tell you it has 28 parts. It is a 28-factor test that the IRS uses to determine whether somebody is an independent contractor or an employee. In other words, it is incredibly, it is stupidly complicated.

So my Gig Act would very much simplify the classification and would provide for expanded reporting. If we had expanded reporting, Mr. George, do you believe that we would have better compliance with participants in the gig economy?

\*Mr. George. There is no question about that, sir.

\*Mr. Rice. Okay. Is anybody here familiar with IRS technology, the technology issues IRS faces?

Mr. McTigue, I understand that the IRS still uses COBOL running programs. Even if we had these reporting things improved, is the IRS really able to match up the reporting with the returns?

Have we got that level of technology right? We really should have had it right 40 years ago, but is it right today?

Are we at the point where we can match up 1099s with tax returns successfully?

\*Mr. McTigue. Congressman, that is a very good question. I think actually the IRS has made significant progress in updating various systems with modern technology relational databases to do just what you are talking about.

And I would mention the W-2 systemic verification that IRS implemented because

of the act that Congress passed to speed up the deadline on the W-2 so that IRS can start matching and checking returns before refunds go out.

So they do have the technology. The old technology that you are referring to is still of concern because that is some of their core systems. The individual master file does have decades old technology, COBOL language, various generations of assembly language, and you know, the IRS needs to move quickly.

They have just issued a 6-year plan to try to once again migrate that system.

And then the issue that we are talking about is a lot of the downstream systems that interface with that individual master file do use the modern technology, but you know, there is a critical risk there in that core function falling apart.

\*Mr. Rice. Thank you.

\*Chairman Neal. I thank the gentleman.

With that let me recognize the former Revenue Commissioner in the State of California, Ms. Chu, to inquire.

\*Ms. Chu. Thank you, Mr. Chair.

Closing the tax gap has been an issue that has been very important to me. You see, prior to Congress, I was a member of the Nation's only elected tax board, the Board of Equalization, which collected taxes for the State of California.

When I was on the board, we had a tax gap of about \$8.5 billion. So we developed an aggressive series of 22 actions in the areas of reporting, auditing, and sharing of information across agencies and jurisdictions, as well as educational outreach to businesses.

I, in fact, did a tax amnesty bill which allowed people to come forward and pay their liabilities without penalty for a 2-month period. It was supposed to bring in \$300 million, but ultimately brought in \$4.8 billion.

But all of this requires personnel, and that is why on the Federal level I am so

concerned about the declining resources of the IRS.

So, Inspector General George, the IRS budget has been repeatedly cut since Republicans took over the House in 2011. The cuts have forced IRS to curtail some of its most basic functions. That would seem to be the easiest way to target for more enforcement.

Specifically, I would like to take a closer look at non-filers. Non-filer accounts for \$32 billion of this tax gap, and these are taxpayers who are required to file a return and have not done so in a timely manner.

In a 2016 report looking into IRS' processes for dealing with non-filers, your office found that taxpayers who filed extensions, but did not end up filing a return were actually not at all pursued by the IRS for tax year 2012 and 2013.

We know that individuals who file an extension generally have a higher income than the average taxpayer. Ultimately, it seems that the IRS determined that they could not follow up on these expired extensions because of a severe lack of resources.

Furthermore, more recent data show that new investigations of non-filers dropped from \$2.4 million in 2011 all the way down to \$362,000 in 2017. That is 85 percent less than what we had in the original year.

So it is clear that this lack of pursuance of high income non-filers is costing the Federal government millions and millions of dollars.

So can you tell us what you found when you took a closer look at IRS' strategy to address non-filers over the years?

\*Mr. George. Major gap, low hanging fruit on the part of the Internal Revenue Service, but to their credit, while that program was suspended for a while, it has been renewed, and so not to the extent that it should be. It still needs a lot of wrapping up and it could use additional resources, but they are now addressing those problems.

\*Ms. Chu. Are they addressing it to the extent that they were before?

\*Mr. George. We are going to look at that, and I will be able to give a fuller response at a future date, Congresswoman.

\*Ms. Chu. And what can Congress do to ensure that the agency is going after these non-filers to the extent that it was?

\*Mr. George. Oversight hearings, such as what you are having today, and there is no question if the IRS did have additional resources that were devoted to that purpose, they could do more.

\*Ms. Chu. Then let me ask about another resource issue, which is audits. The IRS conducted 675,000 fewer audits in 2017 than in 2010, which is a drop of 42 percent. And these inadequate enforcement of the tax laws disproportionately harms lower income taxpayers in a typically regressive effect.

It is reported that the IRS audit operations now mainly focuses on correspondence audits, which are conducted entirely through mail and focus on straightforward errors basically in their returns.

So field audits have gone way down, but it is a more comprehensive audit conducted in person, and they typically impact high net worth individuals and large corporations with complicated filings, which then would yield higher dollar amounts.

Since we know that these wealthy filers contribute the highest dollar amounts to the tax gap, why is the IRS focusing more heavily on less productive correspondence audits?

So what are the consequences to this?

\*Mr. George. I referenced this earlier. Easier to accomplish is one reason, again, mailing a letter versus having someone spend hours sitting across a table with someone with very complicated returns.

It is a cost-benefit analysis on their part, Congresswoman. As I stated before, audits

are the most productive way for the Internal Revenue Service to address the underpayment and underreporting of taxes, but it is time consuming and expensive.

\*Ms. Chu. Thank you.

Thank you. I yield back.

\*Chairman Neal. I thank the gentlelady.

With that, let me recognize the gentleman from Pennsylvania, Mr. Evans, to inquire.

\*Mr. Evans. Thank you, Mr. Chairman. And I thank you for this hearing.

I am going to kind of follow up on my colleague from California. Our tax system is founded on the idea that all taxpayers should pay what they owe.

You would agree with that, Mr. George, would you not?

\*Mr. George. Yes, definitely.

\*Mr. Evans. So if that is and you said earlier that you go where the money is, and you mentioned Willie Sutton, which I think was arrested in Pennsylvania, Mr. Chairman, and put in jail at Eastern State Penitentiary.

So can you please discuss some of the recommendations you have made regarding auditing coverage of high earners?

And has the IRS implemented any of those recommendations?

\*Mr. George. They have implemented some of them, and once again, further use of the automated reporting system and having that tool, which is very effective if used correctly, devoted to high income taxpayers.

There is a very interesting quirk that is in the IRS' policies which, for whatever reason, lists the threshold for high income taxpayers as \$200,000.

\*Mr. Evans. Correct.

\*Mr. George. Yes. And so we have recommended that they raise that so that that

also would capture, again, more of the high income people.

And there is an assortment of them sort of beyond what I have just mentioned that if you would permit me to provide you in a follow-up correspondence, I would appreciate that.

\*Mr. Evans. I would appreciate, you know, obviously submitting that to the Chairman relating to that.

\*Mr. George. If Mr. Chairman would allow that.

\*Mr. Evans. But I think that going back to the premise, as I said, that if we want to ensure, and this committee has the oversight responsibility of showing that every taxpayer pays what they owe, I mean, clearly, that is what this discussion is all about, tax gap and tax compliance. And that is why we are asking the questions that we are asking today, to really understand the center message that people are responsible, that they should pay their taxes.

I stress that part.

There is another question I want to ask then. In terms of expanding the gig economy, what are your findings regarding the types of jobs associated with this sector of the economy and its contribution to the tax gap?

\*Mr. George. I am not sure I followed you.

\*Mr. Evans. Well, in your findings regarding the types of jobs associated with the sector of the economy and its contribution to the tax gap, you mentioned sort of the gig economy.

\*Mr. George. Yes.

\*Mr. Evans. So the question I am asking is what portion. You sort of mentioned Uber or Lyft. That is one sector that you mentioned.

\*Mr. George. Right.

\*Mr. Evans. Okay. So to what degree do you think they are contributing to the tax gap?

\*Mr. George. We do not have actual numbers. I have actually requested that we see if we could monetize, you know, the exact amount.

But what it really boils down to, you have two issues here. One, again, is the reporting threshold. It is \$20,000 or more and having certain other requirements related to it.

But then you also have the issue, as was pointed out, whether someone is characterized as an independent contractor or not. And that has more implications other than just for tax purposes. It is whether the person is entitled to health insurance and whether or not Social Security contributions are made and whether or not as it relates to payroll taxes, whether there is a contribution from the employer or is solely the responsibility of the employee.

\*Mr. Evans. The other area I want to get to real quickly, you also mentioned in your report the international tax gap. Are you aware of the reasons why the IRS has not come up with an estimate in terms of that to the equation?

And how important is the international tax gap in understanding the bigger picture of this issue?

\*Mr. George. It is one of the black holes in the entire discussion of the tax gap. While a component, a very small component of the international tax gap is a part of what the IRS reports as, you know, the tax gap of 300-plus or, you know 400-plus billion dollars.

It omits a very large percentage of money that would be a part of or assigned to the international tax gap, which is literally, again, the amount of money not paid in full on time by international organizations with tax obligation to the United States.

\*Mr. Evans. Thank you, Mr. Chairman.

\*Chairman Neal. I thank the gentleman.

With that, let me recognize the gentleman from Texas, Mr. Arrington, to inquire.

\*Mr. Arrington. Thank you, Mr. Chairman.

And, panelists, I am a law and order guy. It does not do any good to pass laws if we cannot enforce or that we will not enforce or do not enforce.

I know there is a lot of commentary on why things are not being accomplished the way we would like, all of us. The \$400 billion nut is a big one, and we have got to reduce that, and I know you guys are all coming forward with ideas and strategies to that end.

Mr. Wood, the Commissioner is not here. He is the CEO. Give me the three things that our Commissioner, appointed by the President, CEO of the IRS, give me two or three things that he is going to do to ensure that we enforce the law and that we get the monies that are due to our government to run the people's business.

\*Mr. Wood. Well, as a retiree, I cannot tell you what the Commissioner is going to do. I can tell you --

\*Mr. Arrington. Dr. Herndon, let me just get that. Dr. Herndon, tell me about you. Tell me the Commissioner's plan to bring in the revenue that is due this great country and our government.

\*Mr. Herndon. I mean, the one part of his plan that I think he has been vocal about and I think a number of us agree on is that the IRS could do more with more resources.

Short of that, I think you should hear from the Commissioner himself as to what his priorities are.

\*Mr. Arrington. Has he told you what they are?

\*Mr. Herndon. I mean, no, not directly.

\*Mr. Arrington. Has he told --

\*Mr. Herndon. We discuss them in leadership meetings and things of that sort, but



I mean, he has a number of priorities right now that he is working through, and I think he would be happy to talk to you about them.

\*Mr. Arrington. As the Commissioner for the IRS, I would hope that the vision and game plan would be understood by every single employee, every single employee because \$400 billion is a lot of money owed to this government so that we can run it for the people who spend their hardworking tax dollars to make sure that we are enforcing the laws that we pass on their behalf.

Mr. George, I read where the high audit potential strategy, that is, there is a method, a methodology of identifying audits that will have the greatest return on our time and resources, but, in fact, I think a recent report stated that or found that that was not necessarily the case; that in too many, maybe in the majority of cases, they are not returning for high potential. They are actually returning as if they were low potential audits.

Is my statement accurate? Did I read that right?

And what do we do to fix that process?

\*Mr. George. Actually though, we have found that when audits are conducted of high income people, the return on investment, to use that expression, is high. So when they do audit high income people, they tend to make assessments of amounts due that are larger and are worth the effort.

\*Mr. Arrington. So let me just make sure I did not misread it. I thought I read where there were high audit potential audits, those identified for maximum return on time and resources, that were not returning that way. If that is not true, I will move on to the next question, but that is what I thought I read.

I thought that was one of your audits, 2019, this year.

\*Mr. George. You know, I have just been informed that I may have misunderstood

you. If you are talking about the DIF, and that is the formula that the IRS uses to determine who gets audited and who does not get audited, the DIF does not discriminate functions.

It does not work as well. So you know, I have my subject matter expert here.

\*Mr. Arrington. I will follow up with you after the hearing.

\*Mr. George. Yes.

\*Mr. Arrington. I do not want to put you on the spot. I know you cannot know everything.

Let me change subjects for Mr. McTigue in my final less than a minute now. You know, you have got to enforce the law, and I was at a regulatory agency. We examined banks at the FDIC back in the Bush era, and if we did not have the examiners, we could not figure out which banks were safe and sound.

I mean, it is part of doing your job. I do not disagree with that. But I do not want to throw good money after bad. I want to make sure you are utilizing technology, and I have heard some reports that that is not happening and that you are having problems, and that this high risk list that you mentioned, Mr. McTigue, you said of the couple of the five factors, that there is not an action plan that is being followed through, and their monitoring is weak.

I mean, we have got to make sure that those things are happening, at a minimum.

I have run out of time --

\*Chairman Neal. Well, let the witness finish.

\*Mr. Arrington. Okay. Mr. McTigue, would you comment on that please, on those two components of criteria for high risk agency?

\*Mr. McTigue. Sure. Given the scope of the tax gap, I mean, it touches over 150 million individual taxpayers on the individual side, corporations. We talk about international tax clients as well.

So the scope of the tax gap is huge, and so you are absolutely right in terms of having an action plan and monitoring efforts. We have identified various aspects where we think IRS could do a little bit better job.

It is not that they are not doing anything in those areas.

\*Mr. Arrington. Sure.

\*Mr. McTigue. And, in fact, if you look at the first criteria, the leadership commitment, we give IRS very high marks in terms of their commitment and dedication, you know, from the top of the agency on down focus on this issue.

So IRS understands the problem. As I said in my oral opening statement, we believe that the tax gap has to be attacked on multiple fronts, multiple strategies, enforcement, taxpayer service, tax simplicity. All of those would help the tax gap.

So it is hard to point to one particular action. You cannot point to one particular action that IRS is not doing to --

\*Mr. Arrington. My time has expired. Thank you, sir.

\*Chairman Neal. I thank the gentleman.

Let me recognize the gentleman from Illinois, Mr. Schneider, to inquire.

\*Mr. Schneider. Thank you, Mr. Chairman.

I want to thank the witnesses for being with us today and for your important testimony.

It has been repeatedly noted today Americans are bearing the significant burden of the tax gap. This committee has responsibility to ensure the public has confidence that our tax code is being administered fairly.

That goes to the core of what this hearing is about. Our constituents are expected to pay their taxes in full and on time. With both the declining in IRS funding and a 40 percent decrease in enforcement staffing levels, it is no surprise some power interests and greedy

individuals are trying to dodge their obligations.

One area of concern for me is the cost to the American taxpayers from supposed charitable and social welfare organizations that get special tax preferences and then abuse those preferences for personal gain or self-dealing.

I am also concerned that such egregious behaviors are not being adequately pursued by the IRS.

Inspector General George, if I can, what I would like to do is just raise a few scenarios that could represent improper behavior by a tax-exempt organization and get just a yes or no answer if you think the activity is troublesome or would worry and what would warrant for an investigation.

The first one, let's suppose a board member of a nonprofit organization owns a company that sells millions of dollars in products and services back to that same nonprofit organization and at inflated prices. Do you find this troubling? Yes or no?

\*Mr. George. It is concerning.

\*Mr. Schneider. How about a senior executive and a top fund raiser for a nonprofit organization has a stake in a media company that the nonprofit directs millions of dollars in business to? Should this activity raise any flags?

\*Mr. George. It would raise questions, sir.

\*Mr. Schneider. What if the newly selected president of the board of directors of a nonprofit organization subsequently received a contract with more than a million dollars from the nonprofit's largest vendor within days of assuming his new position? Would this create a likely conflict of interest?

\*Mr. George. It depends on the circumstances. That potentiality exists.

\*Mr. Schneider. Something that you would look at?

\*Mr. George. Yes.

\*Mr. Schneider. Last scenario. Let's say the CEO of a nonprofit charged hundreds of thousands of dollars of lavish travel expenses to the nonprofit's largest vendor without adequate documentation? Would that be something that the IRS should look into?

\*Mr. George. Definitely.

\*Mr. Schneider. Okay. So thank you, Inspector General.

But I will ask again. We laid out four scenarios just presented. If they were actual cases, would these warrant further investigation of possible abuse of the nonprofit tax-exempt organization?

\*Mr. George. Yes.

\*Mr. Schneider. Thank you.

I agree, but as you might have surmised, these scenarios are not hypothetical. They are allegations of self-dealing within the NRA, the 501(c)(4) organization with 5 million members.

It is incredibly disturbing to see these allegations and to think that NRA executives are possibly misappropriating their donors' contributions and using their nonprofit status for personal gain, and the American taxpayer is subsidizing the bill.

This morning I sent a letter to the IRS Commissioner, and I sent a copy to you, requesting an investigation into these allegations and whether they warrant reconsideration of the NRA's tax-exempt status. I would appreciate your attention to this matter.

More broadly, in 2018, the office published a report. Your office published a report on the process for investigating referrals of impermissible activity by tax-exempt organizations.

Given the follow-up since the report and your interactions with IRS management, do you believe there are adequate policies and procedures currently in place to enable the IRS to examine improper conduct by tax-exempt organizations and whether the IRS has

sufficient information and resources to uncover abuse?

\*Mr. George. They instituted extensive revisions to their existing policies and a most recent review of it shows that they are following those new policies, and we eventually will follow up again to ensure that mistakes are not being made.

But as of now, they are taking the steps that they committed to us that they would take.

\*Mr. Schneider. Okay. But one of the concerns in the report was that referral of potential abuse of nonprofit organizations had not been followed up. Have those been subsequently followed up upon?

\*Mr. George. We did. Most of them, I believe, have been provided. There were some that were not, but a lot were.

\*Mr. Schneider. Okay. And then, as we look forward, what more could be done to address the tax-exempt sector to ensure honest, hardworking Americans are not paying the prices of the tax cheats and organizations that get subsidized and special tax preferences and then violate our tax codes?

\*Mr. George. You know, again, this may not necessarily be a direct response to your question, Congressman, but there is an important issue that really has not been addressed at all, Mr. Chairman and Congressman, the underground economy, and the impact that it has on the tax gap is just unknown, but just use your imagination as to what that is.

I mean, obviously, underground economy, we are suggesting illegal activity, but not necessarily illegal activity, but activity that is completely done in cash, again, usually whether it is a bitcoin exchange or whether it is some other or just cash. That is not even being considered in this overall discussion.

\*Mr. Schneider. Great. Thank you.

And with permission, I would like to submit for the record the articles from the New Yorker April 17th and May 7th at this time.

\*Chairman Neal. So ordered.

[The information follows:]

\*\*\*\*\*COMMITTEE INSERT\*\*\*\*\*

\*Mr. Schneider. Thank you.

\*Chairman Neal. I thank the gentleman.

With that let me recognize the gentleman from New York, Mr. Suozzi, to inquire.

\*Mr. Suozzi. Thank you, Mr. Chairman. Thank you for holding this hearing.

Thank you, gentlemen, for being here today. We appreciate your testimony very much.

I want to get back to the very basic concept here. We think that there is over \$400 billion a year that the Federal Government is due from taxpayers and different entities that they are not getting, and that money comes from people that do not file at all. It comes from people who file who underpay, and it comes from people who do not even file at all.

And we think that if we could bring this money into the Federal Government, we could reduce the deficit without affecting otherwise people who are legally paying their taxes.

So I just want to read a quote from an article I just read. It says, "People who evade taxes are not just cheating the government. They are also stealing from their neighbors who are following laws and regulations. Cutting IRS spending as policy makers have done in recent years is penny wise and pound foolish. While it is unreasonable to expect to receive all taxes that are owed the government, the IRS could do far more if they had the resources."

And I think that is what you just talked about before, Dr. Herndon, and said we need more resources. It is very simple. We do not have enough resources to do the audits, to collect the money from the people that are not paying their taxes.

So we need to go after people and make sure that they are paying their fair share of taxes, and we need to do that not because we need to catch every single person, but if people feel like there is a threat of enforcement, then a lot of other people will comply.



So would you agree with that, Mr. George?

\*Mr. George. Not only would I agree with it. Even though it is dormant now, the Tax Oversight Board, which was also created under the Restructuring and Reform Act of 1998, they did a study, sir, and again, it is somewhat dated, but vast majority of people when posed with the following question, do you believe that you should pay all the taxes that you owe, 99-plus --

\*Mr. Suozzi. People do pay most of their taxes. Just some people that are not and some entities that are not.

\*Mr. George. The moment they changed the question and it was phrased you learn your neighbor down the block is not paying the taxes that she owes. Do you still believe that you should pay everything that you owe? And the numbers fell dramatically.

\*Mr. Suozzi. Right. So I think would everyone just a yes or no. Do you agree that we need more resources for the IRS in order to go after and do a better job auditing?

Do you agree, Mr. McTigue?

\*Mr. McTigue. I would agree. You know, we have looked at --

\*Mr. Suozzi. I just want a yes or no.

\*Mr. McTigue. -- could be more efficient.

One important point, IRS also serves to educate taxpayers and help them comply. Eighty-five percent of taxpayers comply voluntarily. And a 1 percent change in that voluntary compliance rate would equate to 30, \$35 billion a year.

\*Mr. Suozzi. So we want more people to comply. So we need resources to help do that.

Dr. Herndon, you already told us. Mr. Wood, I am going to assume you agree. So I do not want to waste any more time on the things I want to say.

So right now the IRS has fewer than 10,000 revenue agents; is that correct? Does

anybody know the answer to that? Fewer than 10,000 revenue agents.

\*Mr. George. That is correct.

\*Mr. Suozzi. Did you know that the last time that the IRS had fewer than 10,000 revenue agents was in 1953, when the economy was one-seventh of the size it is today?

So less than 10,000 revenue agents today. The last time we had less than 10,000 revenue agents was in 1953, when the economy was one-seventh of what it is today.

In fact, there are 675,000 less audits today than there were in 2010, and so let me just give you some examples.

Thirty-two billion people a year that are supposed to file their tax returns do not file their tax returns, and in the old days -- old days? -- 2010, we did 2.4 million investigations of the people who did not file, 2.4 million.

Do you know what it is today? Three hundred sixty thousand. Now, that is billions of dollars we could bring in.

Did you know that when someone does not pay the taxes they owe, if nobody does anything about it, within 10 years they are off scott free? In the old days, we used to bring in \$8.3 billion. Now we bring in -- no, this is not the right number. I am sorry.

In 2010, \$482 million were forgiven in people that owed taxes and 10 years expired. In 2017, \$8.3 billion were forgiven in taxes that were owed that nobody went after for 10 years.

So we just simply, I think, need the resources. We heard you have 1,600 less revenue agents today than you did before. Let's say that we had 1,600 revenue agents and they cost us \$100,000 a piece, with their salaries and benefits. You know, they are entry level employees, and they get health insurance and retirement, all of that, \$100,000 apiece.

Sixteen hundred times 100,000 is \$160 million. You told us before that each revenue agent can bring in \$2 million. That is \$3.2 billion. For \$160 million we could

bring in \$3.2 billion.

Does that make sense to you, Mr. George?

\*Mr. George. Revenue agents are actually even more productive than the revenue officers, who I was referencing earlier in my discussion.

\*Mr. Suozzi. They are even more productive than the \$2 million per person. They could bring in even more than \$2 million per person.

\*Mr. George. That is correct.

\*Mr. Suozzi. It seems like a good investment to me. I think we have got to get off this whole topic of President Obama, President Trump, Affordable Care Act, this, that, the other thing. We need more resources for the IRS to go after people and doing audits and encouraging voluntary compliance.

Thank you, Mr. Chairman.

\*Chairman Neal. I thank the gentleman.

Let me recognize the gentleman from New York, Mr. Reed, to inquire.

\*Mr. Reed. Well, thank you, Mr. Chairman.

And to follow up on what my colleague from New York was just articulating, just so we are all on the same page, so there has been no testimony, and I think the testimony has been very clear that how many employees would we have to hire at the IRS to collect the whole \$486 billion tax gap?

Just because \$2 million per revenue officer is supposedly going to get this magical \$3.2 billion into the pocket does not mean that if you have got enough employees you would get the full 486.

Is that not correct, Mr. George?

\*Mr. George. That is correct, yes.

\*Mr. Reed. So one of the things I really want to focus on today is, you know I have

an old adage being raised by my single mom here, whom my father passed with. You know, you work hard, but you work smart.

And, Dr. Herndon, your division of the IRS to me is very interesting and something that I hope we can prioritize as a committee in a bipartisan basis because your whole division is about taking data and effectively using that data to potentially address this tax gap situation.

Is that not correct? Is that not what your whole heart of your mission is to do?

\*Mr. Herndon. By making our -- I think it has been discussed before -- our audit selections smarter, our ability to work cases smarter, yes, that is a factor, right.

\*Mr. Reed. Because no one envisions in the IRS world and in America, I think, having an IRS agent assigned to every American to go through their tax returns, right? That is just not a productive use of time.

And so what we are trying to do is use the data that we have access to at the Federal Government and say there are red flags because the data is able to be mined using computer technology, computer software in a 21st Century capacity to red flag potential abusive, potential errors that people are doing just innocently.

Is that not correct? Is that not kind of one of the hearts that we can agree upon?

\*Mr. Herndon. That is correct, yes, sir.

\*Mr. Reed. Does anyone on the panel disagree with that type of prioritization in regards to allocating Federal resources to accomplish that?

And I notice -- Mr. McTigue, you are going to disagree with that?

\*Mr. McTigue. I would not disagree. I would just take it a little bit further. A lot of the work that Mr. Herndon does has to do with the statistical sample of individual taxpayers.

What we have seen at GAO is on the operational side, IRS can do better in terms of

using the data they collect through correspondence audits, audits of partnerships.

Partnerships, everyone is becoming a partnership. We have seen a decline in the formation of corporations. Partnership growth has gone through the roof.

However, IRS coding of partnership audits, they just throw all large partnerships in one large bucket. We have made a recommendation that they come up with a finer categorization like they do for corporations, which would better inform what they are finding in their audits and, therefore, do exactly what you are saying, audit smarter.

\*Mr. Reed. I appreciate that. That is very good input.

And so just so I am understanding the IRS' capability in order to embrace the 21st century technology that hopefully both sides of the aisle up here can support, the actual institution itself, does it have a commitment or has it moved into the 21st Century, quote, unquote, in order to have the capacity to read that data, to manipulate that data, to utilize that data in that smarter, more effective way/

\*Mr. Herndon. There is a two-part answer to that. The one part, the first part is that in my organization, we have a unique set of tools and technologies and capabilities that --

\*Mr. Reed. Does the entire agency have the capability to read your data?

\*Mr. Herndon. With the right permissions, yes.

\*Mr. Reed. With the right permission. Okay. So there is no underlying software.

Because my understanding, too, is that the COBOL, the old Fortran type of language is floating around in a lot of the IRS. Does the agency itself have the capacity to share that data instantaneously with each other?

\*Mr. Herndon. Some of that has to do with the way that the data is provisioned through the operational systems, which is the subject of the modernization plan that I think you have heard about and that is a priority of the Commissioner.

\*Mr. Reed. And so from your perspectives on the panel, what is the obstacle to the IRS moving away from that antiquated computer software platform into one that is interchangeable?

What is preventing that from happening?

\*Mr. Herndon. Again, I think it is a resources question, and I think modernization plan hopefully is the pathway forward.

\*Mr. Reed. This is cash. You are saying cash, and there is no territorial; there is no pushback from the organization itself saying, "Nope, this is the way we have been doing business for 30 years, and this is the way we are going to continue to do it"? Just cash.

\*Mr. Herndon. Not that I have seen as an impediment to the --

\*Mr. Reed. In the data world.

Mr. George, I think you wanted to respond.

\*Mr. George. You do have to keep in mind it is so methodical. It moves so slowly that by the time they institute one systemic change, it is antiquated. And then they decide, well, this is not really going to work for us in the next 10 years, and they move on to something else. And so --

\*Mr. Reed. It sounds like it needs some good planning techniques maybe could be deployed.

Thank you, Mr. Chairman. I yield back.

\*Chairman Neal. I thank the gentleman.

Let me recognize the gentleman from California, Mr. Panetta, to inquire.

\*Mr. Panetta. Thank you, Mr. Chairman. I appreciate this opportunity. I appreciate this hearing.

And, gentlemen, I appreciate your time today. Although you seem like experts in this field, I am still sure that there was some preparation that went into your testimony. So

thank you for that as well.

Clearly, the tax gap as we have been talking about today is not just a number showing us what we could be collecting in taxes. It is also a failure of us to collect those taxes.

It is a gap that demonstrates that there still are a number, a number of issues in our tax administration from the difficulties facing the IRS to the priorities or lack of priorities that we have set for audits and collections.

It shows us how Congress can be shortsighted in attempting to reduce deficits, but also how a lack of investment can be costly in the long run.

It shows how the complexity of our tax laws are not just challenges for taxpayers, but for our tax collectors as well.

It shows us how honest mistakes by low income families can be punished but tax avoidance by the wealthy can be rewarded.

I am hopeful that today's hearing is providing some insight into how we can better invest in the IRS, fix our laws to discourage tax gaming, and reduce the burdens of compliance for those with lower incomes.

Now, I think you have heard a little bit today, but obviously you know that members of Congress on both sides of the aisle have expressed concerns about rising deficits, and I am one of those members, but in many circumstances, failing to properly invest in our institutions can backfire and clearly leave our country in more debt.

Nowhere is this better demonstrated than our lack of investment in the IRS, especially after what we heard today. We know that for every dollar Congress appropriates to the IRS, \$4 is collected. Each dollar invested can receive an even greater return if it is spent directly on enforcement.

Yet Congress has been starving the IRS of its funding and with consequences for

that tax gap. In fact, since 2010, IRS funding and enforcement staffing levels have shrunk by nearly 40 percent.

Now, Mr. George, excuse me, Inspector General George, you know that well. But if you could, and I am sure you have said this earlier today, but it has been about two and a half hours since you started. What impact are reduced funding levels and enforcement staffing having on the number of audits that IRS can perform?

\*Mr. George. Again, I am going to rely on the actual numbers from when I stated it before, but there is no doubt that conducting audits is the most effective way for the Internal Revenue Service to address the underpayment of taxes by individuals and organizations.

And so when you have fewer revenue agents available to conduct audits, you receive, the government receives fewer receipts, few of the dollars owed to him.

\*Mr. Panetta. Understood, understood. Now, in my district on the central coast of California, I have got about 50,000 families that benefit from the earned income tax credit, which lifted many of them up out of poverty.

But unfortunately, low income taxpayers that take the EITC are more likely to be audited, as we have heard today and as you know, than the taxpayer making nearly one million per year.

Considering the majority of EITC overpayments are unintentional errors and that those who make the errors can be barred from taking the EITC for a number of years, the focus of EIT recipients, we feel, is unfair, the focus on those recipients.

Inspector General George, is this an efficient use of our limited auditing ability?

\*Mr. George. It is a complicated decision, but I am going to give you a quick answer here. The EIT instruction forms, Congressmen, are 30-plus pages long, extremely complicated to explain to taxpayers. The vast majority of people who claim those credits



are doing so through third parties, whether it is a tax assistance center or whether it is a volunteer organization that is doing it or a friend or family.

But so we need to educate, and the IRS needs to be a little more aggressive in terms of third-party people who are preparing tax returns, and especially those with false requests or ultimately determined to be inaccurate requests and penalize them.

There needs to be a response to the people who are engaging, and I want to be very careful about the wording I use here, but who are making mistakes willfully or inadvertently, and this is a very sensitive area.

\*Mr. Panetta. Understood. Thank you.

Thank you, gentlemen.

I yield back.

\*Chairman Neal. I thank the gentleman.

With that I recognize the gentleman from Virginia, Mr. Beyer, to inquire.

\*Mr. Beyer. Thank you, Mr. Chairman.

First, I would like to associate myself with my colleagues in calling for increased resources at the IRS and increased focus on high net worth evaders.

Most of the dedicated civil servants of the IRS, many of them at least are my constituents. I know how hard they work to ensure that the rest of government can function.

I also want to associate myself with the comments of my friend, Earl Blumenauer, to affirm the exemplary service of John Koskinen. When he was IRS Commissioner, he was facing the most difficult job of managing a demoralized agency under constant attack from the then majority in the Congress.

I was the Ambassador to Switzerland in Liechtenstein when the UBS leak cracked open the door of Swiss banker secrecy in a major way really for the first time, and

addressing the problem of Americans hiding money in Swiss banks for tax evasion was the priority of our mission those four years.

And in the wake of the UBS leak, the U.S. was able to secure settlements with a large number of Swiss banks, with many, many delinquent U.S. taxpayers, and hopefully change Swiss bankers' secrecy going forward.

I recognize the complexity and the resources involved in chasing down our most inventive, dedicated, and well-resourced tax evaders, but we also almost on a daily basis had to deal with the counter argument that the U.S. is also a major destination for global tax evaders looking for jurisdictions that will protect their privacy at the expense of their legal obligations, and this was thrown back in my face almost every day.

In fact, the Tax Justice Network ranks the U.S. second only behind Switzerland in its financial secrecy index, and this is largely due to the ease in which anonymous LLCs can be established in certain States. They have been used by money launderers, corrupt government officials, dictators, and even just garden variety tax evasion.

My friend from New York, Carolyn Maloney, has a bill, the Corporate Transparency Act, which will end the anonymity from a law enforcement perspective.

So, Mr. Wood, as a tax attorney for all these years, do these anonymous LLCs and associated financial secrecy tactics make it harder for IRS enforcement to collect the taxes owed to the U.S. Treasury?

And would knowing the true owners of these companies be a helpful tool in closing the tax gap?

\*Mr. Wood. I am sure it would be helpful to the IRS. There is also an awful lot of foreign tax authority who would be interested in getting that information.

On the other side, there are lots of foreign entities that are set up typically by large U.S. corporations, and there is difficulty in obtaining accessed information on them as well.

So it is a two-way street.

\*Mr. Beyer. I do remember in Switzerland when we were demanding that Credit Suisse and UBS turn over the names of all the U.S. taxpayers that had accounts, we had the same challenge, I think. I think it was Brazil or Argentina asking for that from our American banks in Florida.

And I believe it was every member of the Florida delegation, Democrat and Republican, who objected to the Obama administration for not turning those records over.

So the inequality, the asymmetry of that is a huge problem.

Mr. McTigue and Mr. George, Inspector George, you both noted the complexity is a major problem. We now have the new tax code that allows the 20 percent pass-through on LLCs and partnerships. Is that complexity exacerbating the tax gap and to what extent?

Because it is mostly wealthy people that are using this, you know, with passive real estate investments and the like.

\*Mr. McTigue. Congressman, I think it is too early to know for sure how that incentive is going to be exploited or followed carefully. As I pointed out earlier, since 2002, the formation of partnerships or the number of partnerships has grown by 82 percent, whereas the number of corporations has fallen by 28 percent.

So clearly even before the tax reform, there was incentive to move to a partnership form of ownership, and with the new tax law, we will have to see what happens.

\*Mr. Beyer. Inspector George?

\*Mr. George. Yes, sir, and I will associate my comments with those of my colleague here, but I would also note if you have a system of tax compliance or, I guess, sir, having served overseas as an Ambassador, certain nations as you know will fill out the tax forms for their taxpayers and literally present them with a *fait accompli*, a bill that they can contest or amend or what have you, and then otherwise simply sign it and send in, you

know, any tax obligation that they may have to meet.

So the bottom line is making it as simple as possible for someone to fulfill their tax obligation, it would accomplish, I think, the majority of what it is that we're discussing today.

\*Mr. Beyer. Thank you very much.

Mr. Chair, I yield back.

\*Chairman Neal. I thank the gentleman.

Let me recognize the gentleman from North Carolina, Mr. Holding, to inquire.

\*Mr. Holding. Thank you.

And I want to thank the chairman for holding this hearing today.

Closing the tax gap is another area, great area for bipartisan work. We all agree we need to do that, and for bringing before us a great panel of witnesses that have allowed us an opportunity for a really deep and informative dive on the issue.

Now, while we have made sweeping changes designed to simplify the code and encourage increased compliance with the passage of the Tax Cuts and Jobs Act, one large area that we did not address in the taxation is the taxation of Americans who are a resident overseas.

The United States is currently one of only two countries, the other Eritrea, that operates a citizenship-based taxation regime, whereby we tax American residents regardless of where they reside.

And on top of this citizens living and working in other countries, our citizens are suffering with onerous burdens of FATCA and FBAR requirements, among a myriad of issues caused solely by an outdated code as it applies to American residents overseas.

And these burdens hamper the competitiveness of Americans in the global job market often making U.S. citizens around 40 percent more expensive to hire than their

foreign counterparts and have led to a spike of the number of Americans who are renouncing their citizenship every year.

I find it concerning when you travel overseas. You might go to Singapore and go to the American Chamber of Commerce in Singapore, and there are no Americans there.

So my worry is these heavy burdens may encourage noncompliance among individuals living abroad and especially by those so-called accidental Americans that gain citizenship through their parents but have no ties with the United States.

And I really worry about the record number of expatriations that our citizens are affecting around the world. Mr. Beyer from Virginia, as he mentioned, was our Swiss Ambassador, and he, I know from speaking with him, he had to deal with a lot of expatriations and the number is just rising precipitously.

So I think maybe this question would be for you, Dr. Herndon. Does the IRS know the number of Americans living outside of the country as well as how many are not filing or under-filing each year?

Do we know that number?

\*Mr. Herndon. I do not have that number from my organization. We do not have data specifically on that. There may be data accessible to some of the operating units to that effect, but I could not comment.

\*Mr. Holding. So if we do not have that data, we do not have an estimate on the amount of revenue lost due to their noncompliance because you do not know that they exist?

\*Mr. Herndon. Not at this time.

\*Mr. Holding. So do you think the IRS has the capability of discerning this data?

\*Mr. Herndon. Well, certainly with the access to the right data, but you know, to identify the right data sources and the feasibility of acquiring those.

\*Mr. Holding. Well, I am going to find out which one of you I should appropriately follow up with and try to find out that data. I think it would be interesting.

But I would say if we are really interested in going and addressing the tax gap, I think we need to fully understand the problems faced by Americans around the world and craft solutions to simplify the code and encourage compliance for Americans who are resident overseas.

And at the end of last year I introduced a bill that would move the U.S. from the outdated citizenship-based taxation system towards a residency-based taxation system, which is used by every other country, other than Eritrea.

And by simplifying this area of the code and aligning our system with the rest of the world, I think we could not only encourage increased compliance by Americans around the world, but greatly improve the lives and career aspects for Americans globally.

I think it is important that Americans work in countries around the world. It is a great soft power projection. It is also good for security. I know that a lot of our U.S.-based companies who operate globally would really like to have more Americans in the corporate chain of command overseas.

So I hope that we are able to work on this, Mr. Chairman, throughout this Congress.

With that I yield back.

\*Chairman Neal. I thank the gentleman.

Let me recognize the gentlelady from Wisconsin, Ms. Moore, to inquire.

\*Ms. Moore. Thank you so much, Mr. Chairman.

And just let me join my colleagues in thanking this very patient, expert panel.

Many of our members have left, and you are still here. Thank you.

Listen. There has been broad agreement, I think, among this panel as well as our colleagues on both sides that we need more resources for the IRS, education of taxpayers as

well as tax preparers, better technology.

There was some discussion of the morale of the staff at the IRS and the skills gap that is created there.

And I wanted to focus a little bit on efficiency, which has been raised several times throughout this hearing.

I guess, Dr. Herndon, let me start with you. You stated that, quote, "Leveraged data and behavioral analysis to target noncompliance." Could you please explain that a little bit for me?

\*Mr. Herndon. Certainly. There are two components to that, obviously, data and behavior, data being any indicator as we have heard before in a large data context that looks anomalous. In other words, you know, compared to other types of similar looking returns, this return seems to have something that stands out.

So that is one way that we use data to detect potential noncompliance. Again, one among many.

So the behavioral aspect of noncompliance is being able to target or let's say to focus our attention on particular areas where we know from prior experience or prior research we are likely to see noncompliance.

So we know, you know, from --

\*Ms. Moore. Is this something that improves the efficiency? Is this effective?

\*Mr. Herndon. That is correct.

\*Ms. Moore. Is this working?

\*Mr. Herndon. Yes.

\*Ms. Moore. These data, okay.

Let me ask you about efficiency. Many people have asked about collecting taxes from noncompliance or errors with the earned income tax credit. I think Mr. Davis really

raised a number of troubling States and counties where there seemed to be a higher than average tax collection effort, auditing effort.

And as a matter of fact, we have noted that the IRS examine 1.4 percent of the taxpayers claiming the earned income tax credit, but examine less than .8 percent of the individuals who reportedly had \$200,000 to \$1 million in tax liability.

The same thing for small corporations with assets under \$10 million.

I mean, you are more likely to be audited if you claim the EITC than if you are a \$10 million corporation.

Is that one of the examples of inefficiency or have we calculated that the rate of return on collecting the earned income tax credit is greater than if we were to go after these taxpayers?

Maybe I could ask that question of Director McTigue.

\*Mr. Herndon. Again, as I think I might have mentioned earlier, you know, we do not actually set the exam plans or --

\*Ms. Moore. Yes, Mr. McTigue, can you answer that questions for me?

\*Mr. McTigue. Congresswoman Moore, in 2012, we did do a study looking at the examination of different taxpayers and different types of returns, and we found exactly what you were suggesting, that IRS could be more efficient or more productive auditing at a higher rate those earning in excess of \$200,000.

\*Ms. Moore. Thank you so much for that.

Let me ask Inspector General George my last question here. I am running out of time.

Do you think there is some moral hazard in all of these corporations realizing that they can spend money and fight and litigate and that you are going to prioritize going after them because it would cost too much money, and the IRS does not have the resources?



If we all know that here, they know it, too. Is that a fair statement on my part, that there is some moral hazard in people recognizing that we are not going to come after them unless you are getting the earned income tax credit where we have laws and we are going to prioritize getting you?

\*Mr. George. You know, I am of the mindset, Congresswoman Moore, that people generally do the right thing, and especially people who have a lot to lose.

And for corporations, as I said before, there is a difference between tax avoidance and tax evasion. One is legal; one is not legal.

So there are many ways for businesses to legally reduce their tax obligation, and they have the ability to hire expert accountants, expert tax lawyers, so on and so forth, whereas the little person does not have access.

\*Ms. Moore. But the question is with the IRS. Is this a disincentive for us to go after them knowing that they are Corporation X with all of this power?

\*Mr. George. Right.

\*Ms. Moore. Is there a moral hazard within the IRS?

\*Mr. George. I mean, it exists, but again, the IRS will go after people they know have a lot of money that they are owed, that the IRS is owed.

\*Ms. Moore. Sorry, Mr. Chairman. Thank you for your indulgence.

\*Chairman Neal. I thank the gentlady.

With that let me recognize the gentlady from Florida, Ms. Murphy, to inquire.

\*Ms. Murphy. Thank you, Mr. Chairman.

And thank you to all of the witnesses for your testimony.

You know, the tax gap is hard to understand and a seldom discussed topic, but I am glad we are taking the time today to learn that more because when I hear a \$400 billion gap in anything, I want more information.

You know, our tax system is based on a notion of voluntary compliance, and each taxpayer is responsible for calculating the amount they owe and then paying their bill. And this is not always an easy task, and the tax code has only grown in complexity over the years.

Most people and businesses alike act in good faith and try to comply. However, either by accident or choice not everyone pays their bill, and we heard today that we collect about 84 percent of taxes owed, which leaves around \$400 billion uncollected each year, and this is what is known as the tax gap.

We can argue and debate about what the proper level of taxation should be, but regardless of how we feel about how much we tax, we should all agree that people and corporations should pay what they owe.

So to do this properly, I believe we need a properly funded IRS with enough resources to monitor compliance and enforce collection. It is well documented and well discussed during this hearing that the IRS has seen a steady decline in funding over the past decade leading to a fewer number of agents in the field and fewer audits performed.

I think this is just another example of how cynical politics has turned the IRS into a punching bag for political purposes and left it short of the resources that it needs to perform an important function.

And as the representative from Florida's 7th Congressional District, I have the proud honor of having the Maitland-Orlando IRS office in my district, and I have heard many times that Congress should examine the resources dedicated to the IRS and if we have enough IRS employees to effectively carry out the mission.

And while our economy grows both in size and in sophistication, we have deliberately hamstrung our ability to enforce compliance by not allowing the agency charged with tax collection to keep pace.

I cannot help but wonder if there is an easy answer to improving on that 84 percent compliance rate.

Mr. George, do you agree with my premise that Congress has directly impacted the ability of the IRS to conduct effective enforcement of our tax laws?

And could you elaborate on how the size of the IRS workforce has changed over the last 10 years?

\*Mr. George. Yes. They at one point had over 100,000 both full time and seasonal employees. They are now down to 80,000 roughly, and so a 20 percent reduction. That is tremendous.

Fewer resources, fewer manpower, fewer results are going to happen from that. So there is no question that that is a factor.

But I do not think this has gotten enough attention, too, though, Congresswoman. And that is, you know, the tax code could assist all of us, the IRS, Congress, and everyone who is involved in this process in achieving the goal of reducing the tax gap.

So you may have heard my testimony and that of others here earlier. More information reporting, a requirement that established by Congress or through regulations by the IRS that certain entities, organizations provide information on the amount of money that they pay employers or, you know, contractors or whatever it is that you decide, Congress decides in, you know, its power to make mandated so that it is available to the IRS for them to make these decisions as to what is ultimately owed, and then ultimately that helps the taxpayer because they really will pay what they know they owe.

\*Ms. Moore. But there has been a trend and a push of late to simplify, right, be able to file on a postcard. Do you think that works in contradiction with what you are suggesting that we need more information?

\*Mr. George. I know this was a debate recently had by Congress about how much

of a role the IRS itself should have in assisting taxpayers comply with their tax obligations. So I think the discussion was should the IRS produce tax returns for taxpayers similar to what I made reference to earlier about other countries sending an effective tax bill and then having people just send back information.

So, yes, simplicity would help a tremendous amount.

\*Ms. Moore. Great. Thank you.

What do you think would be the first and most obvious impact if the IRS had greater funding and personnel?

\*Mr. George. Well, they would have to have, especially in the area of the tax gap, they need to develop a modern strategic plan. They have not updated that since 2007. So that is the first starting point. All right?

And then once they do that, they can allocate resources that 100 million more and in an appropriate manner.

\*Ms. Moore. Thank you.

\*Chairman Neal. I thank the gentlelady.

Let me recognize the gentlelady from California, Ms. Sanchez, to inquire.

\*Ms. Sanchez. Thank you, Mr. Chairman, and to our witnesses for being so patient in joining us today.

While there have been many issues that have been raised today that deserve our attention, one thing that I want to particularly focus in on is the fallout from congressional action related to the IRS.

Now, we know that for a decade the Republicans have slashed IRS funding, which has had devastating effects across the agency, and of course, as we have heard from testimony earlier, perhaps the largest impact has been on the staffing for audits.

A statistic that I found staggering from today's TIGTA testimony comes from their

report that the audit rate has decreased from 1.11 percent of all returns in 2010 to .5 percent in 2016.

And there also appears to be a big disparity in audit coverage. The chance of being audited if you file a return with an EITC claim and earn under \$25,000 is greater than it is for someone who earns up to \$999,000 or if you are a small corporation with under \$10 million in assets.

And that just kind of blows my mind because it gives me images of trying to get, you know, blood from a turnip versus going where the money is.

There was a recent article that highlighted the number of exams occurring in areas where people lived below the poverty line and showing that that is higher than the number where the median income is among the highest in the country.

Inspector General George, your testimony notes that high income taxpayers have the most opportunity to engage in tax avoidance. Is the IRS's current audit program unfairly weighted towards low income taxpayers?

\*Mr. George. We are reviewing that now, and I will be able to respond definitively once that review is completed.

\*Ms. Sanchez. Do you have a hunch as to whether that is true or not?

\*Mr. George. Well, again, the bottom line is higher income individuals have access to expert accountants and tax lawyers whereas lower income individuals do not, and so you can take it from there in terms of the ultimate result.

\*Ms. Sanchez. Do you think compliance might be increased if the IRS shifted its audit focus away from low income taxpayers to those who are in higher income, or do you think the very virtue of the fact that higher income individuals have resources to combat?

\*Mr. George. Well, again, as I stated earlier in this hearing, higher income audits do result in more tax assessments being made, and so in effect people owing more and

paying more when they are done.

So, yes, it would be beneficial if the IRS refocused its attention.

\*Ms. Sanchez. I seem to recall that there was an initiative in the IRS to examine high income, high wealth taxpayers. Whatever happened with that initiative?

\*Mr. George. I do not know the answer to that.

\*Ms. Sanchez. Okay. With the limited time that I have left, I would like to talk about the IRS workers themselves. Director McTigue, earlier this year, the GAO reported that hiring freezes, retirements, and low morale have shrunk the IRS' enforcement workforce.

Can you give us more insight into the long-term consequences that this can have on the agency and the important mission that it is tasked to carry out?

\*Mr. McTigue. Absolutely. As Inspector General George pointed out earlier, Enforcement has a very high deterrence in terms of noncompliance, and so you know, we have all pointed out that audit rates have fallen 40 percent or audit personnel has fallen 40 percent since 2010.

So, you know, fewer audits, it is logical that compliance may take a hit. You know, there is a lot of noise in the numbers right now in terms of the voluntary compliance rate. So it is hard to measure that for sure, but it certainly is a concern.

\*Ms. Sanchez. Because I will tell you what I hear from my constituents when I am back home. Most people do not love paying taxes, but most people are okay with paying their taxes as long as they think that everybody is paying their fair share.

And where people start to get angry is when they feel like they are being targeted and they are paying their fair share and other people who have more resources or more means are avoiding taxes and not paying their fair share.

And so I would just leave you with the thought that voluntary compliance might

actually increase if there was a belief that everybody who owed their taxes, that enforcement was applied equally to everybody who owed taxes.

And with that I will yield back to the Chairman.

\*Chairman Neal. We thank the gentlelady.

Let me recognize the gentleman from Nevada, Mr. Horsford, to inquire.

\*Mr. Horsford. Thank you very much, Mr. Chairman, and I appreciate you for holding this critically important hearing to discuss the nuances of the tax gap.

Today I want to talk about how the tax gap impacts some of the most vulnerable constituents in my district. Clark County in Southern Nevada is the highest audited county in my State. And while we know that there are many factors that contribute to IRS audits, one thing is clear. There are notable disparities in the way the IRS audits people and the agency's use of limited enforcement resources.

For instance, the agency ends up auditing taxpayers who earn their wages, many of them low income, at a disproportionate rate instead of pursuing wealthier individuals or large corporations, as has been noted throughout this hearing.

In fact, IRS shows that individual making an average of \$25,000 a year who claim the earned income tax credit were more likely to be examined by the IRS than wealthier Americans making up to a million dollars.

I want to paint a clear picture as to what that looks like. In Nevada, a single mother of two trying to make ends meet on a \$25,000 a year salary may be able to receive a tax credit of \$4,133 through the earned income tax credit, and while that amount of money may seem nominal to some, to that single mother and her family it can make a world of a difference in whether or not they are able to survive.

Meanwhile, low and moderate income families who are seeing the greatest challenges, the IRS is not going after large corporations in the same capacity. Over the

past 5 years, there has been a significant decline in audits for corporations with assets of \$10 million or more.

Ten years ago, every large corporation with assets of \$20 billion or more were audited, and today only 50 percent face IRS reviews.

So we must ask ourselves why are some of our most vulnerable Americans facing more scrutiny under the IRS than the wealthy and corporation.

Director McTigue, can you share with me how many returns are filed by individuals and corporations every year?

\*Mr. McTigue. Yes, Congressman. The number of individual tax returns filed each year is about 150 million. The number of tax returns filed by corporations, I believe, is in the order of 7 million.

To speak to your point in terms of --

\*Mr. McTigue. I thank you. Thank you. I have some other questions.

How many audits does the IRS do every year?

\*Mr. McTigue. How many audits does IRS do every year? The most recent figure is that we have looked at show a little bit less than one million.

\*Mr. Horsford. So 150 million individual income tax returns on average, total all type, including corporations, about 250 million, and of that number about 1 million are audited; is that correct?

\*Mr. McTigue. That is correct.

\*Mr. Horsford. How many of these audits are on taxpayers who claim the earned income tax credit?

\*Mr. McTigue. The numbers that I have suggest about 381 exams were performed on people who received the EITC in 2017.

\*Mr. Horsford. Three hundred and eight-one thousand.



\*Mr. McTigue. Thousand.

\*Mr. Horsford. Of the nearly 1 million. Do we see a problem with that proportionate targeting of low-income individuals?

\*Mr. McTigue. Congressman, in 2012 we did a study that suggested that IRS would reap \$1 billion more in enforcement revenue if they reallocated their enforcement resources from low income to higher income tax returns.

However, I do want to note that it is not simply IRS' discretion. There are other statutes and regulations that require IRS to audit a certain number of EITC returns because it falls under IPERIA, the improper payments, and under that --

\*Mr. Horsford. Reclaiming my time, thank you. I appreciate that.

And I am not suggesting they should not be audited, but they should not be audited at a disproportionate rate than millionaires and big corporations, and if your study indicated that we could yield a billion dollars more by ensuring that we are being fair across the board, then we should approach that policy in that process.

Thank you very much for your time today.

Thank you, Mr. Chairman.

\*Chairman Neal. I thank the gentleman. With that, let me recognize the gentleman from California, Mr. Gomez, to inquire.

\*Mr. Gomez. Thank you, Mr. Chairman.

I think what you are hearing is a frustration because a lot of us do represent working class communities, some mixed communities, but very working class.

One of my Republican colleagues earlier made an argument that a more simple tax code would increase compliance and reduce the tax gap. You all seemed to agree with that basic premise.

Who, on average, has a more simple tax return? Somebody who makes \$25,000 a year and claims their earned income tax credit or someone who makes between 200,000 and \$1 million a year?

Mr. George?

\*Mr. George. It would really depend on the circumstance.

\*Mr. Gomez. On average, on average.

\*Mr. George. But obviously, if you have less deductions, less dividends, it would seem that you would have an easier time or should have an easier time.

\*Mr. Gomez. So on average, you know, this is what I am trying to paint for the American people. On average, somebody who is making \$25,000 or less a year, claims the EITC, is going to have a more simple, straightforward return versus somebody who has more deductions and somebody who makes between 200,000 and \$1 million.

But as people were pointing out, the people that are claiming their earned income tax credit are actually more likely to be audited, and that is where it just does not gibe.

And if we are serious, as you all noted, if you are serious by reducing the tax gap, you go after the people that owe the most money.

Earlier at the beginning, you quoted, I guess, Willie Sutton. I had to look him up because I am not part of that generation. You know, why do you rob banks? It is because they go where the money is.

But it does not seem like all of you are going where the money is. Even later in the testimony, Mr. Wood said or I think he also testified if you want to collect taxes, go after high net worth individuals and corporations.

But then the statistics show that that is not what is going on, and if we want to even highlight that even further, Mr. George, when you responded to some questions, you said when they do audit high net worth individuals, the return on investment is higher, right?

So that is what is bothering people. That just logically speaking seems that you are going after the small fry, the person that like instead of going after the Willie Sutton who is robbing the bank, you are going after the kid who stole a pack of gum.

I am not saying that both individuals should not be held accountable according to the law. That is not what I am saying. All right? I am saying that that is what we have to do, but it feels insulting to working class Americans that they are being treated differently.

Also, just to add insult to injury, Inspector General George, you testified that the IRS collection staff has been slashed; also that the IRS uses private debt collectors and reviewed this program.

What did you find?

\*Mr. George. The program has had various forms over the course of the last 20-plus years, and the most recent incarnation, there are currently three groups who have contracts with the IRS to conduct this activity.

It is a mixed bag in terms of the results.

\*Mr. Gomez. Yes.

\*Mr. George. They are given some of the most difficult cases by the IRS.

\*Mr. Gomez. Mr. George, let me. Because I am running out of time. Even though I go last, I have a lot to say.

One of the things I want to just kind of point out on your report to Congress that is titled the Fiscal Year 2019 biannual independent assessment of private collection agency performance, on page 6, it says, "Average number of outbound calls per taxpayer account CBE group was 106.1," 106.1.

Am I reading that correctly? The IRS debt collector is calling each constituent on average 106.1 times.

\*Mr. George. That is correct.

\*Mr. Gomez. How many calls do you think is too much?

\*Mr. George. I do not know the answer to that question, sir, but it seems like a lot. It does seem like a lot.

\*Mr. Gomez. Because other debt collectors were a lot less, correct, like on average?

\*Mr. Herndon. My understanding, yes.

\*Mr. Gomez. So it is my understanding that the IRS previously also agreed to exclude from these private debt collectors the debts of SSI and SSDI recipient, and SSI and SSDI, as you know, are some of our most vulnerable constituents.

Yet the National Taxpayer Advocate's report states that over 12,000 SSDI recipients were assigned to private debt collectors in fiscal year 2018.

Why are we calling these people over 100 times?

\*Mr. George. Yeah, this program definitely needs review, which we are doing, Congressman, because it is a very sensitive area. There is no question about that.

\*Mr. Gomez. And my point is that it does feel that people who are working class get the short end of the stick, especially the folks that are struggling to get by.

Mr. Chairman, I yield back.

\*Chairman Neal. I thank the gentleman.

Let me thank our witnesses today, and I want to say personally and professionally how lucky America is to have people of this competence come in to testify here.

It is a reminder, again, of the professional staffers across Capitol Hill and the agencies and what they provide every day in terms of the certitude of knowledge.

So I am very grateful for the testimony you offered today.

And please be advised that members have two weeks to submit written questions to be answered later in writing. Those questions and your answers will be made part of the

formal hearing record.

And with that the committee stands adjourned.

[Whereupon, at 1:15 p.m., the Committee was adjourned.]

Submissions for the Record follow:

[Michael Bindner](#)

Question for the Record from Mr. LaHood [follow](#):

Additional Materials from The Honorable J. Russell George [follow](#):

Additional Materials from The Honorable J. Russell George [follow](#):