2022

# Fighting the Tax Gap: A Prime and Recent Example of the Value of GAO Oversight & Reporting

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ULWR Paper

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## I. Introduction

Perhaps the most persistent and detrimental issue that the Internal Revenue Service (IRS) has ever faced is that of the "tax gap." In fact, the tax gap — a term which refers to the approximate difference between the amount of tax that taxpayers *should have* paid in a given tax year and the amount of tax that they *actually* paid — has been such an ongoing issue for the IRS that it has been part of the Government Accountability Office's (GAO) "High Risk List" since the list's inception in 1990.[1] Consequently, Congress has asked the GAO to identify the major impediments to reducing the tax gap, to assess the IRS's approach to addressing those impediments, and to propose strategies for the IRS to implement to overcome them. But even though the GAO has suggested numerous ways for the IRS to develop and improve its internal practices to lower the tax gap, the IRS has shown a reluctance to execute many of their proposals. Furthermore, GAO's recommendations have been partially or completely unaddressed in some cases due to a lack of agreement between the IRS and the GAO. In fact, the "Enforcement of Tax Laws" section of its 2021 High Risk List states that, as of December 2020, there were 213 "open" recommendations related to addressing the tax gap, including some that are deemed "high priority."[2]

[1] U.S. Gov't Accountability Off., GAO-19-558T, Tax Gap: Multiple Strategies Are Needed to Reduce Noncompliance (May 2019).
[2] U.S. Gov't Accountability Off., GAO-21-119SP, High Risk Series: Dedicated Leadership Needed to Address Limited Progress in Most High-Risk Areas (Mar. 2021), https://www.gao.gov/highrisk/enforcement-tax-laws.

Among other things, the IRS has attributed its lack of progress in implementing the GAO's recommendations to a combination of scant resources and struggles performing its routine operations in addition to pandemic-related duties. Moreover, in areas where the IRS has taken steps to implement the GAO's recommendations, its ability to do so has been stymied by: (i) limited information reporting for certain income categories; (ii) continued reliance on outdated information technology (IT); and (iii) a lack of specialized auditors in its enforcement workforce.

However, legislation enacted by Congress in the past two years may enable the IRS to finally overcome those obstacles and implement the GAO's recommendations with regard to: (i) developing and implementing a strategic plan to fill the skill gaps in its tax enforcement workforce; and (ii) accelerating its IT modernization efforts to prepare new and existing systems for implementation. Even so, however, the recency of these laws and the uncertainty surrounding their long-term results indicate that GAO oversight and reporting will continue to be crucial in tracking their impact on tax law enforcement and the IRS's progress in reducing the tax gap.

## II. Background

In order to put the tax gap issue in perspective, it is important to first understand some of the reasons why the tax gap has been such a pervasive and serious issue for both the U.S. government and American taxpayers. But to do so requires starting with a detailed overview of: (i) what makes up the tax gap; and (ii) key issues impacting the IRS's ability to address the tax gap.

A. *What makes up the tax gap.*

In looking at the primary factors that contribute to the tax gap, it is important to note that the IRS periodically issues tax gap estimates in an effort to assess historical trends. Starting in 2016, these estimates' figures reflect three-year averages across consecutive tax years. The key figures reported by these estimates include: the overall rate of noncompliance; the voluntary compliance rate (VCR); and the net compliance rate (NCR). As the IRS explains, the VCR is "a ratio measure of relative compliance" that "corresponds to the gross tax gap," and is defined as "the amount of 'tax paid voluntarily & timely' *divided by* 'total true tax', expressed as a percentage." Similarly, the NCR is "a ratio measure corresponding to the net tax gap," that is defined as "the sum of 'tax paid voluntarily and timely' and 'enforced and other late payments' *divided by* 'total true tax', expressed as a percentage."[3]

According to the IRS's 2016 Tax Gap Estimate, which covers tax years 2008 to 2010, the average Gross Tax Gap was estimated at $458 billion, while the Net Tax Gap was estimated at an average of $406 billion across those three tax years.[4] Then, in the 2019 Tax Gap Estimate, which covers tax years 2011 to 2013, the IRS estimated an average Gross Tax Gap of $441 billion, and an average Net Tax Gap of $381 billion.[5] Finally, the IRS's most recent Tax Gap Estimate — issued in 2022 and covering tax years 2014 to 2016 — reported that the average Gross Tax Gap was estimated at $496 billion, while the average Net Tax Gap was estimated at $428 billion.[6] While these figures are certainly concerning on their own, they become even more

[3] Internal Revenue Service, "Tax Gap Estimates for Tax Years 2008-2010," Pub. 1415 (Apr. 2016).
[4] *Id.*, 3 attach. 1.
[5] Barry W. Johnson & Peter J. Rose, "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013," Internal Revenue Service, Pub. 1415, 8 fig.1 (Sept. 2019).
[6] Melanie R. Krause et al., "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014-2016," Internal Revenue Service, Pub. 1415, 8 fig.1 (Oct. 2022).

alarming when put in perspective. For example, as noted in a GAO report from 2019, if the IRS had been able to reduce the average net tax gap for tax years 2008 to 2010 ($406 billion) by just one percent, it would have generated enough additional revenue to fund: around 82 percent of the IRS's enforcement budget; the entire operation of the U.S. Census Bureau; or the combined budgets of the national park system's Operations account, the Smithsonian Institution, and the National Archives and Records Administration in fiscal year 2019.[7] Perhaps most importantly, however, some projections estimate that the tax gap will be as high as $7.5 trillion between 2020 and 2029.[8]

While it is worth highlighting that these estimates are inherently subject to a degree of sampling error, it is equally important to note that the key components of the calculations for each of these tax gap estimates have remained constant. First, these estimates are calculated based on data for the five types of taxes that the IRS collects (e.g., individual income, corporation income, employment, estate, and excise taxes). Second, the "gross tax gap" estimate — the amount of uncollected tax liability before deducting "enforced and other late payments" collected — is made up of three discrete sources: the "nonfiling" tax gap (the tax not paid on time by taxpayers who do not timely file required returns); the "underreporting" tax gap (the net understatement of tax liabilities on timely filed returns); and the "underpayment" tax gap (the amount of tax reported on timely filed returns that is not paid on time).[9] Now that the factors

[7] U.S. Gov't Accountability Off., GAO-19-558T, Tax Gap: Multiple Strategies Are Needed to Reduce Noncompliance.
[8] See Natasha Sarin & Lawrence H. Summers, *Shrinking the Tax Gap: Approaches and Revenue Potential*, Nat'l Bureau of Econ. Res., Working Paper 26475 (Nov. 2019), http://www.nber.org/papers/w26475.
[9] U.S. Dep't of Treasury, "The American Families Plan Tax Compliance Agenda" (May 2021).

that contribute to the tax gap have been identified, it is time to examine why the IRS has struggled to address it.

B. *Key issues impacting the IRS's ability to address the tax gap.*

As discussed, the source of the tax gap is comprised of three separate categories of noncompliant taxpayers. In the aggregate, however, these sources do not contribute to the tax gap equally. In fact, a closer look reveals that the nonfiling and underpayment tax gap groups have historically made up only 20 percent of the gross tax gap combined (nine percent and eleven percent, respectively), while the remaining 80 percent of the tax gap is attributed to the underreporting tax gap.[10]

This discrepancy is primarily due to the underreporting tax gap's connection to high-income taxpayers who are more likely to generate income via "pass-through" entities (e.g., sole proprietorships, partnerships, LLCs, and S-corporations) and/or use other complex tax evasion schemes to obscure their income and evade audit detection. In fact, the IRS's individual gross income tax gap estimates have repeatedly confirmed a correlation across all income categories between misreporting rates and the amount of information reporting. For example, the IRS's 2022 tax gap estimate shows that income categories that are "subject to little or no information reporting" have yielded a markedly higher "net misreporting percentage" (NMP) than those categories that are "subject to substantial information reporting."[11] In particular, the NMP for the "wages and salaries" category in 2014-2016 was one percent, while the NMP for the category that includes "nonfarm proprietor income" was around 55 percent.[12] The cause of this wide

[10] *Id.* at 4.
[11] Melanie R. Krause et al., "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014-2016," 14 fig.3.
[12] *Id.*

variance is that most, if not all, taxpayers who earn wage and salary income receive a Form W-2 from a third-party (i.e., their employer) that is also sent to directly to the IRS. Thus, the IRS can easily identify any discrepancies between what is reported on those taxpayers' tax filings and what is reported by their employer, making noncompliance much riskier and more likely to be audited. Conversely, the lack of information reporting for many high-income taxpayers allows them to misreport their income with little fear of detection and, in turn, skew the underreporting tax gap's impact on the overall tax gap.

But, perhaps the most significant deterrents to reducing the tax gap are the IRS's skills gaps in its enforcement workforce along with its reliance on outdated IT systems. Even though there is considerable overlap between those two issues, it is best to start by examining them separately.

a. *Skill gaps in IRS's workforce.*

As discussed, one of the major hurdles to reducing the tax gap is the limited information reporting to the IRS for certain categories of income. Aiding that problem, however, are the skill gaps in many of the IRS's mission-critical occupations (MCOs) that transpired between fiscal years 2010 and 2018 when its enforcement budget was reduced by a combined 20 percent (equal to $2.6 billion, after adjusting for inflation).[13] Over that period, the IRS lost 20 percent of its overall workforce, and 35 percent of its specialized auditors capable of reviewing complex returns. Consequently, the IRS's audit rates dropped by approximately 45 percent overall

[13] U.S. Dep't of Treasury, "The American Families Plan Tax Compliance Agenda."

between 2010-2018, while its audit rates for taxpayers with more than $1 million in annual income fell by more than 60 percent.[14]

Furthermore, this budget decrease led the IRS to replace its strategic workforce planning activities with more a short-term approach to human capital decision-making. Over time, however, increasing rates of retirement and low employee satisfaction made this new approach unsustainable. So, in 2018, the IRS resumed its strategic workforce planning efforts.[15] Then, in 2019, Congress asked the GAO to review and report on the IRS's strategic planning efforts. According to the GAO, the IRS had not, up to that point, collected sufficient information regarding what mission-critical skills it already had available, areas in which it had skill gaps, and the types of skills it needs going forward. As a result, the GAO proposed a number of executive actions for the IRS Human Capital Office (HCO) to take that, if executed, would diminish the impact of its resource constraints on operations.[16] It also recommended that the Commissioner of the IRS fully implement a strategic workforce planning initiative that involves: (i) conducting enterprise strategy and planning; (ii) conducting workforce analysis; (iii) creating a workforce plan; (iv) implementing the workforce plan; and (v) monitoring and evaluating the results of its plan. But as of March 2022, the GAO's action tracker showed that the IRS has yet to implement all of these recommendations.

Then, in 2021, the IRS's failure to address its workforce concerns took a toll when its staff was overwhelmed by an influx of net operating loss (NOL) refund request applications

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[14] See Internal Revenue Service, *Internal Revenue Service Data Book, 2010*, Pub. 55B, 22 tbl.9a (2011); Internal Revenue Service, *Internal Revenue Service Data Book, 2019*, Pub. 55-B, 34 tbl.17b (2020).
[15] U.S. Gov't Accountability Off., GAO-19-176, Internal Revenue Service: Strategic Human Capital Management is Needed to Address Serious Risks to IRS's Mission (Mar. 2019).
[16] See *Id*.

pursuant to the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020.[17] Among other things, the IRS's lack of processing capacity created a sizable backlog that it is still working to reduce. But more importantly, a report issued by the Treasury Inspector General for Tax Administration (TIGTA) in 2022 stated that the IRS's failure to timely process those NOL refunds cost the federal government at least $42 million in accumulated interest payments in fiscal years 2020 and 2021.[18]

b. *The IRS's reliance on outdated technology.*

In addition to the IRS's skill gaps, though, its ability to combat the tax gap has been hampered by its continued reliance on outdated "legacy systems." In particular, the IRS's 60-year-old core tax processing system, the Individual Master File (IMF), which is used to manage individual taxpayer account data, has constrained its capacity to verify the accuracy of complex tax filings with modern day data analysis techniques. Accordingly, the GAO considers the IMF one of the oldest and riskiest systems in use in the federal government.[19]

In part, the risk associated with using the IMF stems from its role in supplying data, directly and indirectly, to the IRS's other information systems. Yet, the primary reason why using the IMF is risky is that it runs on two programming languages — assembly language code (ALC) and Common Business Oriented Language (COBOL) — that are exceedingly difficult and expensive to support. Since neither language is still taught in schools, the number of

[17] Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, §§ 2303, 2304 (*codified at* 26 U.S.C. § 6428) (Mar. 2020).
[18] Treasury Inspector General for Tax Administration, Rep. No. 2022-36-048, "The IRS's Inability to Timely Process Noncorporate Applications for Refund of Net Operating Losses Under the CARES Act Delayed Taxpayer Refunds and Cost Millions of Dollars in Additional Interest" (Sept. 2022).
[19] See U.S. Gov't Accountability Off., GAO-22-104387, Information Technology: Cost and Schedule Performance of Selected IRS Investments (Oct. 2021).

programmers who can update the IMF's code to incorporate changes in the tax law each year is gradually thinning. Thus, as The Gartner Group (a prominent IT consulting company) cautioned in 2008, the IRS must pay more to retain employees with the skills necessary to update the IMF.[20] Moreover, ALC is incompatible with modern-day computers and must be run on computers from the 1960s instead. To illustrate the threat to the tax system posed by continuing to update the IMF, Treasury officials have stated that, "by analogy, the IRS has erected a 50-story office building on top of a creaky, 60-year foundation, and it is adding a few more floors each year. There are inherent limitations on the functionality of a 60-year-old infrastructure, and at some point, the entire edifice is likely to collapse."[21]

Then, in 2009, the IRS acknowledged the need to replace the IMF and created a development plan for a new system called the Customer Account Data Engine 2 (CADE 2) with the hopes of modernizing the primary tax processing functions of (and eventually replacing) the IMF. As part of its plan, the IRS split CADE 2's implementation into two "transition states." According to the IRS's initial forecasts, CADE 2's "transition state 1" was scheduled to be completed by 2012, while transition state 2 was to be finished by 2014.

Since then, however, GAO reports evaluating the IRS's efforts to develop CADE 2 have disclosed repeated poor planning and spending trends that have slowed and even halted its progress. For example, with regard to its planning, a GAO report issued in May 2016 found that the IRS had not, to that point, set a timeframe for completing its IMF retirement plan.[22] Then, in

[20] *Id*. 8 n.14.
[21] Natasha Sarin & Lawrence H. Summers, *Shrinking the Tax Gap: Approaches and Revenue Potential*, 21 n.46 (citing the National Taxpayer Advocate Annual Report to Congress 2018).
[22] U.S. Gov't Accountability Off., GAO-16-468, Information Technology: Federal Agencies Need to Address Aging Legacy Systems (May 2016).

June 2016, the GAO reported that the IRS also had not established a process for allocating funds towards its modernization efforts; in fact, the IRS did not provide its documentation for this process to the GAO until October 2020.[23] Finally, a GAO report from June 2018 found that the IRS had not adopted any strategic risk management practices to assess and mitigate the risks posed by its reliance on mission-critical legacy systems.[24]

With regard to IRS's spending, investments in the CADE 2 project have been equally disorganized and counterproductive. According to one GAO report, the IRS stated that, in 2020, it reallocated personnel and funding originally assigned to CADE 2's development to support other activities, including the issuance of stimulus checks during the COVID-19 pandemic. [25] This in turn delayed one of the key development milestones for CADE 2 by seven months. Furthermore, the timeline for completing transition state 2 has been pushed back by a total of nine years (from 2014 to 2023) due to multiple revisions (or "rebaselines")[26] to the cost, schedule, and scope of CADE 2 since 2009, including seven times between 2016 and 2019.[27] And, in June 2021, the IRS announced that it did not plan to fully replace and retire the IMF until 2030. While these delays are troubling from a progress standpoint, a greater concern is that, as of September 2020, the IRS has spent nearly $1.47 billion on CADE 2, which is roughly four times more than its initial cost projections for completing both transition states.[28]

[23] U.S. Gov't Accountability Off., GAO-16-545, Information Technology: IRS Needs to Improve Its Processes for Prioritizing and Reporting Performance of Investments (June 2016).
[24] U.S. Gov't Accountability Off., GAO-18-298, Information Technology: IRS Needs to Take Additional Actions to Address Significant Risks to Tax Processing (June 2018).
[25] U.S. Gov't Accountability Off., GAO-22-104387.
[26] A "rebaseline" in this context refers to an agency's decision to modify a project's original cost, schedule, and/or performance goals (i.e., its baseline) to reflect changing circumstances to its development.
[27] *Id*.
[28] *Id*. at 21.

## III. Analysis

Keeping in mind the barriers to reducing the tax gap described above, it is now time to: (i) discuss and evaluate steps taken by both Congress and the executive branch to overcome them, and (ii) examine, where necessary, what more could be done to help the IRS. To do so, this section will focus on: (1) the Taxpayer First Act of 2019; (2) the American Rescue Plan Act of 2021; and (3) the Biden Administration's proposals under the American Families Plan and the Inflation Reduction Act of 2022. Furthermore, this section will consider what, if any, additional moves and/or changes can be made to improve these initiatives to maximize their impact.

### A. *The Taxpayer First Act of 2019.*

First, in 2019, Congress enacted the Taxpayer First Act (TFA) [29] as what would seem to be a response to the GAO's reports on the tax gap. Intended to reform the IRS's operations, this bill amended various provisions of the Internal Revenue Code (IRC) related to IRS's taxpayer services; enforcement procedures; cybersecurity and identity fraud protection practices; IT management; and use of electronic systems. With regard to addressing the tax gap, however, the most important provision of the TFA is section 2101, "Management of Internal Revenue Service Information Technology."

Under this section, the role and responsibilities of the IRS Chief Information Officer (CIO) were formally codified. In particular, § 2101(a)(3) of the TFA stipulates that the IRS CIO shall: "(A) be responsible for the development, implementation, and maintenance of information technology for the [IRS]; (B) ensure that the information technology of the [IRS] is secure and

[29] Taxpayer First Act, Pub. L. 116-25, 133 Stat. 981 (July 1, 2019).

integrated; (C) maintain operational control of all information technology for the [IRS]; (D) be the principal advocate for the information technology needs of the [IRS]; and (E) consult with the Chief Procurement Officer of the [IRS] to ensure that the information technology acquired for the [IRS] is consistent with (i) the goals and requirements specified in subparagraphs (A) through (D), and (ii) the strategic plan developed under paragraph (4)."[30]

In addition, § 2101(a)(4)(A) of the TFA requires the IRS CIO to "develop and implement a multiyear strategic plan for the information technology needs of the [IRS]," which shall: "(i) include performance measurements of such technology and of the implementation of such plan; (ii) include a plan for an integrated enterprise architecture of the information technology of the [IRS]; (iii) include and take into account the resources needed to accomplish such plan; (iv) take into account planned major acquisitions of information technology by the [IRS]; and (v) align with the needs and strategic plan of the [IRS]." In conjunction with those duties, subparagraph (B) of this section establishes a formal reporting duty for the IRS CIO by requiring that, on at least an annual basis, they must "review and update the strategic plan under subparagraph (A) . . . to take into account the development of new information technology and the needs of the [IRS]."[31]

Finally, § 2101(b)(1) – (3) of the TFA, which explicitly applies to the development and implementation of CADE 2, instructs the IRS Commissioner to (i) "enter into a contract with an independent reviewer to verify and validate the implementation plans (including the performance milestones and cost estimates included in such plans) [for CADE 2]"; and (ii) "complete the

[30] *Id*. at 133 Stat. 1008.
[31] *Id*. at 133 Stat. 1008-1009.

development of plans for all phases of [CADE 2]" within one year of the TFA's enactment (i.e., July 1, 2020).[32]

When reading these provisions of the statute, it seems reasonable to surmise that Congress sought to introduce parameters to the IRS's approach to IT development that mirror what the GAO has previously proposed. In other words, this section creates enforceable grounds by which IRS officials may now be held accountable for failing to take actions that would fulfill GAO's recommendations. Regardless of Congress's intent, the TFA nevertheless conveys a message to IRS leadership that it wholly expects them to expedite its IT modernization efforts, and that it plans to monitor its progress going forward. And, thus far, it seems that that message has been received given that the *IRS Strategic Plan FY 2022-2026* not only directly references the TFA in its "Message from the Commissioner," but also expresses its commitment to narrowing the tax gap in two of its four strategic goals (Enforcement and Transformation)."[33] Still, two subsequent GAO reports indicate that the need for persistent oversight continues.

First, in the "Addressing the Tax Gap" portion of the GAO's 2021 High-Risk List, the GAO reported that only one of its five criteria (Leadership Commitment) has been "met"; that three of the criteria (Action plan, Monitoring, and Demonstrated progress) have been "partially met"; and that the last criteria (Capacity) was "not met."[34] For the three "partially met" criteria the GAO explained that, whereas the IRS has taken some preliminary steps to modernize its enforcement systems, it still lacks proper qualitative measures for determining the success of its new compliance programs and for deciding what corrections, if any, to make once those systems

[32] *Id.* at 133 Stat. 1009.
[33] Internal Revenue Service, *IRS Strategic Plan FY 2022-2026*, Pub. 3744 (2022).
[34] U.S. Gov't Accountability Off., GAO-21-119SP.

have been put into practice. And, for the criteria that was "not met," the GAO found that the IRS has yet to finalize and administer the strategic planning initiatives previously recommended for addressing mission-critical skill gaps in its enforcement workforce.

Then, in October 2021, the GAO conducted a "Cost and Schedule Performance" audit pursuant to various provisions of the Joint Explanatory Statement of the Financial Services and General Government Appropriations Act of 2020[35] which: (i) reviewed the performance reports of the IRS's IT investments, such as CADE 2; and (ii) examined the IRS's progress reports regarding the execution of its IT modernization plan. On one hand, this report affirmed that the IRS has made some progress modernizing portions of the IMF while operating within the schedule and cost parameters set for CADE 2's development in 2019 and 2020. But, on the other hand, the GAO also expressed concern about the fact that numerous revisions to the cost, scope, and schedule of CADE 2 have deferred the completion of its transition state 2 milestone by nine years. As mentioned, one of those adjustments was the IRS's decision to reallocate CADE 2 funding and personnel towards activities arising from the COVID-19 pandemic. Furthermore, however, the IRS CIO informed the GAO in May 2019 that it had decided to de-scope several CADE 2 activities to focus on updating components of the IMF and that, as a result, it will now incrementally replace only core functions of the IMF over the next decade.

While such revisions and reallocations may not explicitly violate the provisions of the TFA cited above, they do constitute a pattern that requires further scrutiny since, as one of the footnotes provides, the GAO has previously found that some agencies use recurrent rebaselining

[35] H.R. Rep. No. 116-122, 22 (2019) (Comm. Rep.).

to conceal cost overruns and schedule delays.[36] Thus, the GAO concluded that the delays to CADE 2's development and the IMF's retirement demand "consistent high-level management attention" going forward. And, although it is worth noting that neither the High-Risk List report nor the Cost and Schedule performance report incorporate material from the *Treasury Strategic Plan 2022-2026,* the *IRS Strategic Plan FY 2022-2026*, or the IRS's *Fiscal Year 2022 Agency Financial Report,* the facts and circumstances surrounding this matter support the GAO's conclusion. For instance, some of the IRS's comments in its written response to the Cost and Schedule report call into question whether the agency has been using its best efforts to abide by Congress's demands. Specifically, in its letter to the GAO an IRS official called the IMF "one of the most critical systems in the federal government" and stated that, "[d]espite its limitations, the system continues to perform and enable the IRS to implement legislative mandates."[37] While those statements could simply be an attempt to justify the IRS's questionable decisions, when considered in conjunction with the IRS's lack of progress such comments may also suggest that the IRS condones its use of the IMF regardless of the risks associated with doing so.

B. *The American Rescue Plan Act of 2021.*

Next, in 2021, Congress enacted the American Rescue Plan Act (ARPA) in order to accelerate the United States's economic recovery following the COVID-19 pandemic. As it pertains to efforts to reduce the tax gap, though, the ARPA: (i) apportioned about $1.2 billion towards the IRS's modernization plan, and (ii) amended section 6050W(e) of the IRC to require that all "third party settlement organization[s]" (e.g., app payment services such as Venmo,

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[36] See U.S. Gov't Accountability Off., GAO-08-925, Information Technology: Agencies Need to Establish Comprehensive Policies to Address Changes to Projects' Cost, Schedule, and Performance Goals (July 2008).
[37] *Id*., app'x III.

PayPal, Zelle, and CashApp) report to the IRS any information regarding "third party network transactions" that exceed $600.[38] In other words, this amendment, which falls under § 9674 of the ARPA, has shifted the reporting threshold by now requiring that those payment app providers file a Form 1099-K with the IRS for users whose "business transactions" total $600 or more in the aggregate in a given tax year. Here, business transactions are essentially any payments made for "goods and services." So, by incorporating this provision into the ARPA, Congress has taken a step towards increasing the IRS's access to third-party income reporting that falls in line with the GAO's recommendations. For context, the former rule only required such reporting if an individual's account made 200 or more business transactions *and* if the total gross amount of such payments made in that year equaled at least $20,000.[39]

But, while it is too soon to know how this change will affect noncompliance rates, there are reasons to have both enthusiasm and doubts about the immediate and future impact of the ARPA on the underreporting tax gap. On one hand, since rental income is part of the income category that is "subject to little or no income reporting," there is a degree of optimism that this threshold change could have both direct and indirect effects on voluntary compliance rates for taxpayers who underreport such income. The direct impact, of course, stems from the fact that the new threshold expands the information reporting requirements for popular services like Venmo, PayPal, Zelle, etc. in terms of what they must report directly to the IRS each year. This, in turn, should allow the IRS to crosscheck information that it receives from underreporting taxpayers who use those services to collect rental payments (or to pay for repairs to their rental

[38] American Rescue Plan Act, Pub. L. 117-2, 135 Stat. 185 (2021).
[39] Jeanne Sahadi, *If you use Venmo, PayPal or other payment apps this tax rule change may affect you*, CNN Business (Nov. 9, 2021, 3:49 PM), https://www.cnn.com/2021/11/09/success/payment-app-tax-reporting-feseries/index.html.

properties) with information that is reported by the services themselves. Accordingly, this additional reporting may have a deterrent effect on anyone who routinely use such services by increasing the perceived risk of audit detection for underreporting rental income. In 2018, the Treasury conservatively estimated that the "revenue effect of the indirect deterrence value" of tax compliance programs is at least three times greater than the "direct revenue effect."[40]

But, on the other hand, one could also argue that this new rule may only have a marginal effect on the underreporting tax gap as a whole. To start, the rule imposed by the ARPA has some fairly evident workarounds that may moderate its impact, at least initially. For instance, anyone familiar with apps like PayPal and Venmo likely knows that, when issuing a payment, there is an option to mark whether the payment is for a business purchase. On PayPal, for example, users can select whether the transaction is "For friends and family" or "For goods and services," while Venmo has a swipe option to "Turn on for purchases." The incentive to use these options is that it enables users to get a full refund in cases where an eligible purchase is: (i) not how it was described; (ii) damaged upon receipt; or (iii) not received at all. But, outside of those scenarios, users who choose not to select those options may still be able to avoid crossing the $600 threshold and, thus, limit the amount of income reported to the IRS.

More importantly, this rule change may only deter the relatively small contributors to the underreporting tax gap. As discussed, the biggest contributors to the tax gap are the high-income taxpayers who use pass-through entities and various sophisticated tax evasion methods to obscure their annual income. So, since those individuals are likely to engage in transactions that far exceed even the previous $20,000 threshold, there is reason to doubt whether increasing the

[40] See U.S. Dep't of Treasury, "IRS Budget in Brief FY 2019," 8 (2018).

surveillance of payment services that limit users' from paying more than $2,000 per transaction for goods and services, and limit those transactions to no more than 30 per day, will yield the same direct and indirect effects. Moreover, the ARPA may fail to discourage those who use crypto asset exchanges from continuing to underreport income generated from those sources since it does not apply to virtual currency transactions conducted outside of these platforms.

Thus far, studies have found that the ARPA has increased taxpayers' reporting of income receipts by as much as 24 percent, but also that a parallel increase in expense reporting has offset those income receipts.[41] Accordingly, while the ARPA undoubtedly represents a substantial step forward, Congress will likely need more comprehensive information reporting legislation before the high-income taxpayers will be influenced by deterrent effects akin to those created by the ARPA.

### C. *The American Families Plan and the Inflation Reduction Act of 2022*

Also released in 2021 was the Department of the Treasury's compliance agenda for the Biden Administration's American Families Plan (AFP) proposal. This compliance agenda report outlines the "transformation elements" of the AFP, which, in relevant part, include: (i) providing the IRS with the resources necessary to detect sophisticated tax evaders; (ii) providing the IRS with more complete information; and (iii) overhauling the IRS's outdated technology to improve its capacity to recognize tax evasion and serve taxpayers. Experts at the Treasury Office of Tax Analysis estimate that the AFP's initiatives could narrow the tax gap by 10 percent over the next

[41] See Bibek Adhikari et al., "Information Reporting and Tax Compliance," Am. Econ. Ass'n Papers and Proceedings, 110 (May 2020).

decade, which would equate to $700 billion in additional tax revenue; however, another study estimates that this figure could be as high as $1.6 trillion.[42]

For the first element, the AFP would allot to the IRS: (i) a fixed stream of roughly $72.5 billion in mandatory funding over a 10-year period; and (ii) a "program integrity" allocation estimated at $6.7 billion over the next ten years to be spent on enforcement resources and activities that are projected to save more than they cost.[43] Among other things, the program integrity allocation would help fund the IRS's hiring and retention of about 5,000 new, specialized enforcement personnel to fill the IRS's skills gaps.

Then, for the second element, the AFP seeks to increase the IRS's access to third-party information reporting for partnership, sole proprietorship, and S-corporation income by expanding the use of Form 1099-INT reports issued by financial institutions. According to the compliance agenda, the AFP intends to require financial institutions to include additional data in their annual return filings regarding gross inflows and outflows for business and individual accounts that exceed its de minimis "gross flow threshold." The Office of Tax Analysis estimates that the deterrent effects of this new information reporting requirement could help raise an additional $460 billion over the next decade.

Finally, for the third element, the AFP would dedicate a portion of the mandatory funding allotment ($6 billion) towards the IRS's IT modernization. Of that amount, $4.5 billion will be spent on administering the new information reporting regime. Meanwhile, the remaining $1.5

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[42] See Charles Rossotti & Fred Forman, *Recover $1.6 Trillion, Modernize Tax Compliance and Assistance*, Tax Notes
(Mar. 2020), https://www.taxnotes.com/tax-notes-federal/compliance/recover-16-trillion-modernize-tax-compliance-andassistance/2020/03/02/2c5p2; see also Natasha Sarin & Lawrence H. Summers, *Shrinking the Tax Gap: Approaches and Revenue Potential*.
[43] U.S. Dep't of Treasury, "The American Families Plan Tax Compliance Agenda" at 16-17.

billion will be invested in developing its machine learning capabilities that will allow it to maximize the information it receives and more accurately determine which filings require compliance review. In theory, this additional funding could be used to invest in expanding the functionality of existing systems.

For example, the IRS could use those resources to fund its development of the Return Review Program (RRP), a system that uses advanced data analysis techniques like predictive modeling, business rules, and clustering to detect and select potentially fraudulent returns and curtail the issuance of improper refund payments. According to the GAO's Cost and Schedule performance report, the IRS temporarily terminated its 2020 modernization activities for the RRP before later deciding to reallocate funds from its operations and maintenance budget towards those activities.[44] Under the AFP, there would be no need for the IRS to shuffle money around in this way, which would not only help curb developmental delays, but would also minimize the financial spillover effect of the IRS's modernization plan.

So, if actualized, the AFP could help resolve three of the IRS's most pressing barriers to tax gap enforcement. But, as an article from the Tax Foundation explains, various studies have reached conflicting conclusions about whether the impact of the AFP's proposals will be as extensive as its agenda indicates.[45] First, the article points out that there is some ambiguity surrounding whether the return on investment (i.e., the additional tax revenue collected) generated by boosting the IRS enforcement budget will increase proportionally with the amount of funding. Citing a report by the Congressional Budget Office (CBO), the article explains how

[44] U.S. Gov't Accountability Off., GAO-22-104387.
[45] Alex Muresianu, *Simplifying the Tax Code and Reducing the Tax Gap: What Can Be Achieved?*, Tax Foundation, No. 775 (July 2021).

the CBO found that raising the IRS enforcement budget by $20 billion would yield an average return of 200 percent, while a $40 billion increase would yield an average return of only 120 percent.[46] However, the article also mentions a study by the National Bureau of Economic Research which contends that the CBO's projections are a result of incomplete assumptions about the revenue potential of improving compliance. [47]

Second, the article raises concerns about conflicting studies on the deterrent effect of tax enforcement initiatives on voluntary compliance rates. As previously mentioned, the Treasury estimates that the deterrent effect of enforcement activities on voluntary compliance can create up to three times more revenue than the activity itself. But, as this article states, some studies have found that this is often just a short-term result, especially for high-income taxpayers. And, conversely, other studies have found that conducting more audits can reduce voluntary compliance because it causes a lack of trust in the IRS.

Finally, the article discusses a lack of consensus among tax policy scholars on the efficacy of creating new information reporting requirements. Although it is widely accepted that a lack of reporting requirements leads to higher rates of noncompliance, the article suggests that some categories of income, like proprietorship income, may be inherently simpler to conceal and thus that cannot be affected by additional reporting requirements. These conflicting accounts suggest that the AFP's projections should be viewed with cautious optimism.

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[46] See Cong. Budget Off., "Trends in the Internal Revenue Service's Funding and Enforcement," Pub. 56422 (July 2020), https://www.cbo.gov/system/files/2020-07/56422-CBO-IRS-enforcement.pdf.
[47] See Natasha Sarin & Lawrence H. Summers, *Understanding the Revenue Potential of Tax Compliance Investment*, Nat'l Bureau of Econ. Res., Working Paper 27521 (July 2020), https://www.nber.org/system/files/working_papers/w27571/w27571.pdf.

In any case, however, Congress passed the Inflation Reduction Act (IRA) in 2022.[48] In relevant part, this bill allocates $80 billion through fiscal year 2031 towards IRS enforcement and IT development, and includes numerous provisions intended to improve both information reporting and tax enforcement. Thus, while there is no direct mention of the AFP in the IRA, it appears to be a show of support for the initiatives described in the Treasury's agenda report.

## IV. Conclusion

In light of these developments, its seems clear that the GAO's oversight has greatly influenced Congress actions and the Biden Administration's proposal. As discussed, the three most prominent areas of concern are: (i) expanding third-party information reporting; (ii) implementing a strategic workforce plan; and (iii) developing the IRS's technology. Not only has the GAO's oversight provided key insights on these facets of tax gap enforcement, but it has also helped secure the funding required for the IRS to adopt its proposals. But even so, there is still much to do which will require continued oversight to ensure its success. So, in recapping the analysis above, the steps needed to ensure these three issues are addressed going forward will be summarized.

a. *Improving information reporting.*

By passing the APRA and the IRA, Congress has taken steps to provide the IRS with information that will help it curb tax evasion. But despite the potential of these new initiatives, at this point only time will tell how impactful they will be in practice. In part, their success will depend on whether the IRS can improve its technology and maximize its use of this new

[48] Inflation Reduction Act, Pub. L. 117-169 (2022).

information reporting. So, continued GAO oversight and reporting will play a critical role in tracking both the IRS's IT development and its ability to effect these new information reporting regimes.

b. *Implementing a strategic workforce plan.*

As discussed, the decade-long decline in the IRS's budget was not only the initial cause of the skill gaps in its enforcement workforce, but has also been a deterrent to its resolution. In other words, even though the GAO has offered numerous suggestions to the IRS on this matter, continued resource constraints have left those recommendations unmet. But, with the additional funding that the IRA will provide, the IRS should finally be in a position to implement the GAO's recommendations and address this issue.

Thus far, the best indicators of how the IRS plans to invest its new funding are the *IRS Strategic Plan FY 2022-2026* and its *Fiscal Year 2022 Agency Financial Report*. In these reports, the IRS outlines its four strategic goals (Service, Enforcement, People, and Transformation) for rebuilding its workforce and improving its operations overall. But, while these reports are encouraging, they lack specificity. So, here too GAO oversight of the IRS's strategic workforce planning efforts going forward will be vital to Congress's ability to monitor and assess its progress and to hold IRS management accountable for any missteps or improper spending.

c. *Developing the IRS's technology.*

Finally, because of its relation to the other two matters, GAO oversight of the IRS's IT modernization efforts will likely be the single most important factor in evaluating the success of Congress's efforts to reduce the tax gap. For instance, the effectiveness of the new information reporting regimes under IRA and ARPA will rely heavily on the IRS's ability to develop current and forthcoming systems to maximize its use of this new information. Perhaps the best example of an existing system that the IRS should invest in is its fraud detection program, the RRP. In a report from 2018, the GAO examined the RRP's current capabilities as well as the prospects of using it for other enforcement-related activities and concluded that the IRS should conduct a cost/benefit analysis of expanding the RRP and take any appropriate action based on its findings.[49] But, as previously mentioned, the IRS's development of the RRP has been suspended at various times due to its limited resources.[50] As a result, the GAO's 2021 High Risk List report contains several recommendations for the RRP's development that still need to be addressed.[51] Fortunately, however, the IRA's funding should allow the IRS to put more of its resources towards implementing the GAO's recommendations. But even so, the GAO will need to monitor the IRS's efforts closely to ensure: (i) that its expansion of the RRP stays in line with the initiatives set forth by the ARPA and the IRA; and, at the same time, (ii) that CADE 2's development progress remains on schedule to replace the IMF by 2030.

Accordingly, and as is evident throughout, the importance of GAO oversight and reporting cannot be overstated. On this matter in particular, the GAO's steadfast efforts to examine, track, and guide the IRS has also laid the necessary groundwork for Congress to enact legislation with the potential to make lasting changes that promote and allow for more equitable tax law enforcement. But equally important is the role that the GAO will continue to play as the uncertainties surrounding these efforts to reduce the tax gap unfold and develop.

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[49] U.S. Gov't Accountability Off., GAO-18-544, Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement (July 2018).
[50] U.S. Gov't Accountability Off., GAO-22-104387.
[51] U.S. Gov't Accountability Off., GAO-21-119SP