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SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT
UNITED STATES SENATE

“Closing the Tax Gap: Lost Revenue from Non-Compliance and the Role of Offshore Tax Evasion”

Testimony of
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Washington, D.C.
Chairman Whitehouse, Ranking Member Thune, and Members of the Subcommittee, thank you for the opportunity to provide information on the Internal Revenue Service’s (IRS) efforts to address the Tax Gap. The Tax Gap is a long-standing issue that has been a substantial challenge for the IRS. I first testified on this issue before the Committee on Finance in April 2005. Since then, the Treasury Inspector General for Tax Administration (TIGTA) has performed a significant body of work addressing components of the Tax Gap as well as related IRS compliance and enforcement programs. Finding effective solutions to address the Tax Gap and its components would yield substantial additional tax revenue.

TIGTA was created by Congress in 1998 with a statutory mandate of ensuring integrity in America’s tax system. It provides independent audit and investigative services to improve the economy, efficiency, and effectiveness of IRS programs and operations. TIGTA’s oversight activities are designed to identify high-risk systemic inefficiencies in IRS programs and operations and to investigate exploited weaknesses in tax administration. TIGTA plays a key role working to ensure that the approximately 82,000 IRS employees,¹ who collected more than $3.5 trillion in tax revenue, processed more than 242 million tax returns, and issued more than $736 billion in tax refunds during Fiscal Year (FY) 2020,² have done so in an effective and efficient manner while minimizing the risk of waste, fraud, and abuse.

In this section of my testimony, I will discuss a number of challenges facing the IRS in addressing the Tax Gap and our work to address those challenges.

¹ Total IRS staffing as of January 16, 2021. Included in the total are approximately 13,300 seasonal and part-time employees.
² IRS, Management’s Discussion and Analysis, Fiscal Year 2020. The IRS reported that $275 billion in refunds issued in FY 2020 were the result of COVID-19 economic impact payments paid under the Coronavirus Aid, Relief, and Economic Security (CARES) Act.
IMPROVING TAX COMPLIANCE

One of the IRS’s key responsibilities is to ensure that taxpayers comply with tax laws. If the IRS can increase the rates of voluntary compliance, it can reduce the Tax Gap. The Tax Gap is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year. The gross Tax Gap, which is the amount that is owed by taxpayers before collections resulting from IRS enforcement actions and other late taxpayer payments taken into account, is estimated to be $441 billion annually.\(^3\) The underreporting of income taxes comprises the largest component of the Tax Gap at $352 billion annually,\(^4\) with individual taxpayers being responsible for the largest share of the underreporting Tax Gap at $245 billion. The amounts attributable to nonfiling and nonpayment of taxes at $32 billion and $39 billion, respectively. However, the Tax Gap estimates are generally outdated because they are for tax years of a decade earlier, so their usefulness may be limited. Recently, the IRS Commissioner testified that he believes the annual Tax Gap is at least $1 trillion.\(^5\)

There are a number of different factors that drive voluntary tax compliance. The IRS estimates that information reporting and withholding requirements are significant drivers of tax compliance. For instance, when there is information reporting and withholding at the source, tax compliance is approximately 99 percent. When there is information reporting only, tax compliance is approximately 95 percent. When there is neither withholding nor information reporting, the IRS believes tax compliance is as low as 45 percent.\(^6\)

Sustaining and improving taxpayer compliance is important because small declines in compliance cost the Nation billions of dollars in lost revenue and shift the tax burden away from those who do not pay their taxes onto those who pay their fair share on time every year.

**High-Income Taxpayers Could Be More Effectively Prioritized**

High-income taxpayers generally have more opportunities to engage in planning to avoid taxes. According to the IRS, high-income nonfilers, although fewer in number,  

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\(^3\) Hereafter in this testimony, the Tax Gap refers to the gross Tax Gap.

\(^4\) Improper payments for the Earned Income Tax Credit and other refundable credits are considered a component of this amount.


contribute to the majority of the nonfiler Tax Gap. In March 2021, TIGTA reported that the IRS could more effectively prioritize high-income taxpayers who owe delinquent taxes but do not pay.7 Specifically, TIGTA identified 685,555 taxpayers who had a balance due as of May 14, 2019. These taxpayers reported adjusted gross income of $200,000 or more and owed a combined total of $38.5 billion. Because the IRS prioritizes high balance due cases for collection, many of these high-income taxpayers would be included in high-priority work. However, balances due are not generally prioritized by income earned and some improvements could be made to prioritize high-income taxpayers more effectively. TIGTA also found that revenue officer staffing does not always align with locations where the greatest number of high-income cases are located, because the IRS is understaffed in geographic locations where high-income taxpayers with delinquencies are located. While TIGTA recognizes that resources are limited, hiring or reallocating resources to work high-income taxpayer cases with delinquencies in these areas could lead to increased tax compliance as taxpayers realize that the IRS is focusing on taxpayers who can pay their taxes but do not.

We have also been concerned that the Small Business/Self-Employed Division (SB/SE Division) terminated its High-Income/High-Wealth strategy (HIHW) in 2015.8 The HIHW strategy started in 2010 and was designed to address high-income taxpayers whose total positive income (TPI) was at least $200,000 on Form 1040, U.S. Individual Income Tax Return, and who had not reported all of their earned income. The HIHW strategy consisted of two subcategories: filed returns for High Income Underreported taxpayers, and High-Income Nonfilers, i.e., taxpayers who had earned income necessitating the filing of a tax return but who have not done so. The SB/SE Division’s HIHW strategy was disbanded in 2015 and by the end of FY 2017 the cases pursued under the strategy were closed, though the reasons for the termination of the strategy remain unclear.

However, when the SB/SE Division’s HIHW strategy was in place, it was not focused on high-income taxpayers given that individual tax return examination closures with TPI of less than $200,000 represented the majority (73 percent) of the individual returns closed from the strategy for FYs 2015 through 2017. The SB/SE Division did not cease examining high-income taxpayers after the HIHW strategy was disbanded. In fact, in an environment where declining resources have caused a significant decline in all IRS examinations, the percentage of the SB/SE Division’s high-income high-wealth

8 TIGTA, Audit No. 201930026, The IRS Continues Compliance Efforts for High-Income Taxpayers After Disbanding the High-Income High-Wealth Strategy, but With Less Effective Outcomes. The Final Report for this audit will be issued at a later date.
examination closures for which TPI was at least $200,000 compared to other audits actually increased from 20 percent in FY 2015 to 26 percent in FY 2019. However, total closures continued to drop during this time due to a reduction in available resources and resulted in actual high-income return closures dropping from 47,024 for FY 2015 to 29,610 for FY 2019 resulting in potential lost assessments totaling $1.9 billion. In addition to the decrease in examination compliance resources, TIGTA is also concerned that the IRS is less able to track its progress in auditing high-income taxpayers by eliminating the HIHW strategy.

After disbanding the HIHW strategy, the SB/SE Division increased examinations of high-income taxpayers using the discriminant function (DIF), i.e., the algorithm the IRS uses to choose some examinations, rather than maintaining or increasing High Income Underreported examinations. This change, affecting 1,534 taxpayers, resulted in $121.5 million in potential lost assessments for FYs 2018 and 2019.

TIGTA has also identified significant pockets of tax noncompliance among business owners filing Form Schedule C, Profit or Loss From Business (Sole Proprietorship), who showed no revenue but significant losses (losses larger than $100,000). We reviewed 1,142 returns that contained a loss on at least one Schedule C that was equal to or greater than $100,000, and those audits had an average examination assessment of $53,183, which was greater than the examination results of seven of the 10 top SB/SE Division Field Examination function strategies. Additionally, the results of these examinations have demonstrated that these types of returns are more productive than DIF-selected returns. Yet, the SB/SE Division utilizes DIF to select most of its returns for examination. We recommended that the SB/SE Division establish a compliance improvement project to focus on the tax compliance risk of businesses with at least one Schedule C attached, no gross receipts, and more than $100,000 in losses to evaluate it as a new strategy or workstream; however, the SB/SE Division declined.

For Tax Years (TY) 2011 through 2013, the IRS estimated that the portion of the $441 billion Tax Gap due to underreporters was $352 billion (approximately 80 percent). Of this, $245 billion was from individual tax returns and $37 billion was from corporation income tax returns. Additionally, the portion of the Tax Gap due to nonfilers was $39 billion (approximately 9 percent). TIGTA reported for TY 2017, numerous business and individual nonfiler taxpayers with Form 1099-K, Payment Card and Third Party

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Transactions, income were not identified and cases were not created by the IRS’s nonfiler programs, and in other cases, they were identified but not worked by the IRS.  

Specifically, TIGTA identified 314,586 business taxpayers with $335.5 billion in Form 1099-K income that appeared to have a filing obligation, but were not identified as nonfilers by the IRS. The problem is that the IRS cannot use third-party information returns, such as Form 1099-K data, to identify business nonfilers and create cases if the taxpayers’ accounts are coded as not having an open filing requirement, or no tax account exists because the business has never filed a tax return. TIGTA recommended that the IRS fund and implement a programming revision to its process that identifies these types of business taxpayers. However, the IRS disagreed with this recommendation, citing ultimate approval and implementation of that programming is subject to IRS-wide needs and priorities.

**The Large Business and International Division Strives to Identify Corporate Non-Compliance**

The IRS has struggled to effectively identify the pockets of tax noncompliance in large corporations. For example, we reported that IRS audits of large corporations using the Discriminant Analysis System (DAS) selection tool had a no-change rate of almost 55 percent. Audits that result in no changes can inefficiently consume IRS resources and burden taxpayers who are compliant with the tax laws. TIGTA analyzed the potential cost for excessive time charged to no-change returns, i.e., time in excess of 200 hours, and estimated that potentially $22.7 million was spent examining no-change returns for time periods in excess of 200 hours.

However, the LB&I Division is aggressively addressing these issues. It is in the process of implementing a strategy to update its DAS System selection tool to improve the no-change rates. Additionally, beginning in 2017, the LB&I Division initiated a strategy to audit more on an issue-based system. The LB&I Division refers to this effort as “Campaigns,” which currently cover 57 issues, including virtual currencies, micro-captive insurance, net operating loss carryovers, and many other issues.


11 The DAS is a computer model developed to systemically score the examination potential for Form 1120 returns with total assets of $10 million or more. Generally, the higher the score, the greater the audit potential.

12 A no-change rate is a reflection of the effectiveness of the IRS’s examination selection methods. A high no-change rate suggests that the IRS is not selecting the most productive tax returns for examination and may be burdening compliant taxpayers with audits.
Impact of the Internet Platform Companies on Tax Compliance

Tax Gap studies have found that self-employed individuals underreported their net income by 64 percent (based on the average for TYs 2008 through 2010), which is up from 57 percent in the TY 2001 estimate. With the growth of online platform companies in recent years, which allow people easy and convenient ways to obtain needed services and others to work as self-employed individuals providing those services, it is likely that income and self-employment tax underreporting will continue to be a growing problem.

TIGTA issued three reports addressing a related problem with information reporting in three emerging industries: the gig economy, virtual currency exchanges and peer-to-peer payment businesses. Internal Revenue Code Section 6050W and related Treasury regulations addressed Third-Party Settlement Organizations, who bring buyers and sellers together using the Internet platform and guaranteeing payment for goods and services. The law and Treasury regulations did not require Third-Party Settlement Organizations to issue Form 1099-K, Payment Card and Third Party Network Transactions, unless those transacting business earn at least $20,000 and engage in at least 200 transactions annually.

TIGTA issued an audit report on the gig economy’s impact on tax compliance and the lack of an IRS strategy to address this challenge. The gig economy includes online platform companies, such as ride-share companies, which act as facilitators that bring together people offering goods or services with others that need such goods or services. TIGTA reported that the IRS is not working cases with billions of dollars in potential tax discrepancies involving taxpayers who earn income in the gig economy. Many cases were not selected to be worked by the IRS due to resource constraints and the large volume of discrepancies that were identified. Consequently, many taxpayers who earn income in the gig economy do not receive a Form 1099-K; therefore, their income is not reported to the IRS.

Virtual currency is a digital representation of value, other than a representation of the U.S. dollar or a foreign currency ("fiat" currencies), which functions as a unit of account, a store of value, and a medium of exchange. The use of virtual currency as a payment method continues to grow in popularity and is emerging as an alternative

14 Fiat currency is the name for what is traditionally recognized as currency. Fiat currency is the coin and paper money of a country and designated as its legal tender.
asset to U.S. or other fiat currencies. Virtual currencies are often described as “cryptocurrencies” because they use cryptographic protocols to secure transactions recorded on publicly available decentralized ledgers, called “blockchains.”

Making payments in virtual currency, instead of fiat currency, may allow users to pay lower transaction fees and achieve faster transfer of funds. However, the use of virtual currency may also allow anonymity in transactions and the possibility of avoiding tax reporting obligations. Taxation compliance risks can arise from willful conduct by a taxpayer (e.g., using virtual currency to evade taxes) or non-willful conduct (e.g., lack of understanding of the taxability of virtual currency transactions, calculation of gain/loss from virtual currency transactions, characterization of income, third-party reporting responsibilities).

Virtual currency exchanges allow virtual currency to be readily exchanged for legal tender, and many of them are also Third-Party Settlement Organizations, meaning they did not have to report transactions to the IRS unless such annual transactions exceeded 200 and exceeded $20,000. While these exchanges are in a position to provide important information for use by the IRS in tax administration, information reporting on virtual currency transactions from the exchanges is lacking. TIGTA found that it is difficult for the IRS to identify taxpayers with virtual currency transactions because of the lack of third-party information reporting that specifically identifies virtual currency transactions. As of October 2018, both the LB&I and SB/SE Divisions’ examination functions have started a small number of examinations of taxpayers based on potential virtual currency issues, and the SB/SE Division’s examination function has few known open examinations of virtual currency exchanges.

In addition, the growth of peer-to-peer payment applications (P2P) has greatly enhanced the flow and transfer of funds between users on virtual platforms, making it easier and cheaper to send payments from one person to another. However, the technology presents additional tax compliance challenges in that the payments are not always reported to the IRS and can be hard to detect during an IRS examination. The IRS’s Tax Gap analyses indicate that information reporting is associated with higher voluntary compliance. However, some taxpayers may not report income received via

16 The American Rescue Plan Act of 2021 reduced this reporting threshold to $600 annually so that these organizations are subject to the same reporting requirements as other businesses.
P2P payment applications if they do not believe the IRS has received an information return, such as a Form 1099-K.\textsuperscript{18}

TIGTA judgmentally selected eight P2P payment applications and found that these companies appear not to meet the current definition of a third-party settlement organization, and therefore are not required to file Form 1099-K. However, three P2P companies filed 950,965 Forms 1099-K involving $198.6 billion of payments in TY 2017, which included amounts below the reporting thresholds.

The IRS did not always take compliance actions on nonfilers of tax returns and underreporters related to P2P payments even when information reporting was available. In total, 169,711 taxpayers potentially did not report up to $29 billion of payments received per Form 1099-K documents issued to them by three P2P payment application companies.

When income information is not reported to the IRS, taxpayers are more likely to be noncompliant. A provision was included in the American Rescue Plan Act of 2021 which addressed a TIGTA recommendation contained in this report by addressing the disparity of information reporting between third-party settlement organizations and other types of businesses. Section 9674 of the American Rescue Plan Act changed the exception for \textit{de minimis} payments by third-party settlement organizations, reducing the exception threshold to $600 annually so that these organizations are subject to the same reporting requirements as other businesses.\textsuperscript{19}

\textbf{Resources and Their Potential Impact on Enforcement Revenue}

According to the Congressional Budget Office (CBO), the appropriations for the IRS fell by about 20 percent (adjusted for inflation) between 2010 and 2018.\textsuperscript{20} Approximately 70 percent of the IRS’s overall budget is for labor, and the drop in funding thus resulted in a decline in the number of IRS employees over that period, particularly in enforcement. The CBO estimated the amount of funding and staff allocated to enforcement activities has declined by about 30 percent since 2010. The number of employees who work the most complex examination and collection cases experienced especially large declines. Between FYs 2010 and 2018, the number of


\textsuperscript{19} The exception threshold for \textit{de minimis} payments was previously $20,000 and an aggregate number of transactions exceeding 200.

\textsuperscript{20} Congress of the United States, \textit{Congressional Budget Office, Trends in the Internal Revenue Service’s Funding and Enforcement} (July 2020).
revenue agents, who handle complex enforcement cases, fell by 35 percent, and the number of revenue officers, who manage difficult collections cases, dropped by 48 percent.\textsuperscript{21}

Over the past five years, the IRS’s budget has increased approximately 6 percent, from $10.7 billion in FY 2015 to $11.3 billion in FY 2019. However, funding for each of the IRS’s main budget activities has varied. For example, business systems modernization and taxpayer services budgets have increased 39 percent and 18 percent, respectively, whereas, the funding for enforcement has dropped 2 percent over the same period.

While the IRS experienced a general decline in staffing over the last five years, the amount of total enforcement revenue related to the work performed by these compliance employees has not decreased in total. Although enforcement revenue collected increased 6 percent between FYs 2015 and 2019, from $54.2 billion to $57.5 billion, most of this revenue is collected during the automated collection notice stream in which a series of collection notices are sent to taxpayers owing balances due. Revenue collected by revenue officers in the field for more complicated cases decreased by 24 percent between FYs 2015 and 2019, from $5 billion to $3.8 billion.

Overall, the IRS ended FY 2019 with approximately 74,196 FTEs, a 117 FTE decline from the approximately 74,313 FTE in FY 2018. In addition, the IRS’s compliance programs continued to see a reduction in available resources. The Examination staff steadily declined during FYs 2015 through 2019, whereas, the Collection staff fluctuated during the same five-year period and increased from FY 2018 to 2019.

\textbf{Reductions in Most Types of Examinations}

It is important to note that the IRS’s research showed the greatest compliance impact comes from audits. Audits have a strong positive impact on reporting compliance and have the greatest impact on tax compliance.\textsuperscript{22} The IRS’s primary objective in selecting returns for examination is to promote the highest degree of voluntary compliance. Examination is a vitally important aspect of maintaining a voluntary tax compliance system because approximately 80 percent of the gross Tax

\textsuperscript{22} IRS, The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results (Nov. 2002).
Gap is comprised of underreported tax on timely filed returns. Examinations are the means of detecting and collecting a portion of this tax that is not reported and paid voluntarily. These efforts have a direct impact on the Tax Gap.

The CBO estimated that the IRS lost 15,000 enforcement employees between 2010 and 2018, which led to a significant reduction in the number of examinations and the number of follow-ups on discrepancies between returns and third-party data. Over that period, the number of examinations dropped by about 40 percent even as the number of returns filed grew by 5 percent. Since 2010, the IRS has conducted fewer examinations. Between 2010 and 2018, the share of individual income tax returns examined fell by 46 percent, and the share of corporate income tax returns examined fell by 37 percent.

Furthermore, the percentage decline in the examination rate was larger for higher income returns. For returns with more than $1 million in total income (before losses were deducted), the examination rate dropped from 8 percent in 2010 to 3 percent in 2018, a 63 percent decline. The examination rate for returns with total positive income of less than $200,000, accounted for over 95 percent of individual returns each year, dropped to 0.6 percent in 2018 from 1.0 percent in 2010.

Nonpayment

The component of the Tax Gap related to nonpayment of taxes owed is estimated to be $39 billion annually. However, reductions in resources have also impacted payment compliance. From FY 2015 to FY 2019, field revenue officers have decreased by approximately 14 percent (from 2,612 to 2,239).

As required by the Fixing America’s Surface Transportation Act, the IRS began using private collection agencies (PCA) and implemented the Private Debt Collection (PDC) program. In two prior attempts, PDC programs did not generate sufficient revenue to cover costs and the IRS terminated the programs early with net losses to the Government.

The Joint Committee on Taxation estimated that the current PDC program would yield approximately $2.4 billion in additional revenue through FY 2025. From the launch of the PDC program in 2016 through September 2019, the program generated revenue

totaling $358 million ($276 million in commissionable payments, $27 million in non-commissionable payments, and $55 million in Special Compliance Personnel Program revenue), resulting in net revenue to the General Fund/Treasury of $220 million.\textsuperscript{25} From 2016 through FY 2019, the program’s total cost was $132 million. These collections reflected 2 percent of the total outstanding tax liability assigned to the program, which is well below the national average for the collection of delinquent debts of 9 percent. While the private collection agencies working in this initiative have performed well in terms of the quality of their interactions with taxpayers, TIGTA reported that delinquent accounts assigned to private collection agencies had an average age of 4.75 years. Cases this old are generally uncollectible, and this may explain why the PDC collections are below the national average.\textsuperscript{26}

**Improving International Tax Compliance**

The IRS has not developed a reliable estimate of the international tax gap. The Tax Gap is estimated using statistics from the IRS’s National Research Program data that does not measure international noncompliance. Non-IRS estimates of the international tax gap vary widely (from $40 billion to $123 billion annually).\textsuperscript{27} In 2008, the then-Commissioner of Internal Revenue indicated that the IRS had not measured the international tax gap using other methodologies and did not have an estimate for the number.\textsuperscript{28} Complexity and change in the international tax environment require that the IRS collaborate with tax administrations of foreign countries to enforce compliance. International agreements and tax law changes are important, but the Department of the Treasury and the IRS should follow through to ensure that these efforts achieve their intended results.

For example, TIGTA reported in 2018 that after eight years and spending at least $380 million on IRS systems and efforts to establish international agreements across the globe, the IRS had taken virtually no compliance actions to meaningfully enforce the Foreign Account Tax Compliance Act (FATCA).\textsuperscript{29} FATCA was designed to establish

\textsuperscript{25} Net revenue to the General Fund/Treasury is the total revenue (commissionable payments, non-commissionable payments, and Special Compliance Personnel Program revenue) minus retained earnings. Retained earnings are 50 percent of commissionable payments.


\textsuperscript{29} TIGTA, Report No. 2018-30-040, *Despite Spending $380 Million, the IRS is Still not Prepared to Enforce Compliance with the Foreign Account Tax Compliance Act* (July 2018).
reporting requirements for U.S. citizens with foreign accounts, with significant penalties if foreign accounts were not reported. It was estimated that revenue from FATCA would be $8.7 billion from FYs 2010 to 2020. While initial enforcement-related complications involved data reliability issues, more recent problems are related to the fact that the Department of the Treasury and the IRS have delayed the requirement for Foreign Financial Intermediaries (FFI) to require that United States citizens provide Social Security Numbers when establishing accounts and the FFIs to provide that information to the United States so that the IRS can match compliance information it has with information that the FFIs have.

The IRS must follow through on global tax cooperation efforts and tax administration practices that can prevent and resolve disputes among countries to increase certainty for taxpayers. In most cases, foreign persons\(^{30}\) are subject to U.S. tax of 30 percent\(^{31}\) on their U.S. source income. The U.S. tax owed is generally withheld from payments made to foreign persons by a withholding agent.\(^{32}\) Withholding agents are required to file Forms 1042-S, *Foreign Person’s U.S. Source Income Subject to Withholding*, to report on an individual taxpayer basis the income and withholding for each foreign person. For Tax Year 2017, the IRS received 6.3 million Forms 1042-S from 49,618 withholding agents.

In response to our prior recommendations, the IRS has implemented processes to improve its identification of reporting discrepancies for Federal tax withheld on U.S. source income paid to foreign individuals. However, these processes did not identify some withholding tax discrepancies. TIGTA reported that IRS processes did not identify 1,919 withholding agents with reporting discrepancies totaling more than $182.7 million.\(^{33}\) Our review also identified 366 withholding agents that claimed $506 million more in credits for tax withheld than was reported on the Forms 1042-S.

In addition, partnerships conducting business in the United States are required to withhold taxes on certain income paid to foreign partners.\(^{34}\) The withholding serves as

\(^{30}\) A foreign individual is any person that is not a U.S. person, including a nonresident alien, a foreign corporation, a foreign partnership, a foreign trust, or a foreign estate.

\(^{31}\) A reduced rate, including exemption, may apply when there is a tax treaty between the United States and the country of residence for the foreign individual.

\(^{32}\) A withholding agent is any U.S. or foreign entity (individual, corporation, partnership, etc.) that takes receipt of, has control or custody of, or disposes of or makes a payment of any income to a foreign individual that is subject to withholding.

\(^{33}\) TIGTA, Report No. 2020-40-021, *Continued Efforts Are Needed to Address Billions of Dollars in Reporting and Payment Discrepancies Relating to Tax Withheld From Foreign Persons* (June 2020).

\(^{34}\) A foreign partner can be a foreign corporation, foreign partnership, and any other person who is not a U.S. citizen.
an incentive for foreign partners to file the appropriate U.S. tax return. However, TIGTA reported that the IRS’s compliance efforts in this area can be improved.\textsuperscript{35} TIGTA identified significant errors in the database that the IRS uses to track withholding reported by partnerships. As a result, the IRS’s ability is limited to verifying withholding credits and accurately identifying potential nonfilers.

Foreign individuals are also required to pay tax related to the sale of U.S. real estate. Specifically, the Foreign Investment in Real Property Tax Act of 1980\textsuperscript{36} (FIRPTA) imposes an income tax on foreign persons selling U.S. real property interests. Buyers are required to withhold a percentage of the anticipated taxes due on the amount realized from the sale. A foreign seller of U.S. property can claim a credit for the tax withheld by the buyer. If the seller’s tax liability is less than the amount of tax withheld, the seller gets a refund of the difference. TIGTA reported that the IRS’s reconciliation processes do not effectively identify and address FIRPTA reporting and payment noncompliance.\textsuperscript{37} TIGTA identified 2,988 buyers with discrepancies of more than $688 million between the withholding reported on Forms 8288-A, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests, filed during Processing Year 2017 and the withholding assessed to the buyer’s tax account. Extensive data inaccuracies in the FIRPTA database, incorrect and unclear guidelines, and employee errors contributed to these discrepancies.

The IRS also has not established processes to use Form 1099-S, Proceeds from Real Estate Transactions, to identify buyers that do not report and pay FIRPTA withholdings. TIGTA’s analysis of Forms 1099-S for TY 2017 identified approximately $22 million in FIRPTA withholding that was not reported and paid to the IRS. Finally, employee errors resulted in 1,835 foreign individuals potentially receiving more than $60 million in FIRPTA withholding credits than they were entitled.

With the rising number of taxpayers giving up or abandoning their U.S. citizen or resident status, it is important that the IRS have controls in place to enforce the tax provisions applicable to expatriates. Since the Heroes Earnings Assistance and Relief Tax Act of 2008, the number of taxpayers expatriating increased significantly from Calendar Year 2008 through Calendar Year 2018 (from 312 to 3,974). During the same

\textsuperscript{35} TIGTA, Report No. 2020-30-026, \textit{Withholding Compliance Efforts for Partnerships With Foreign Partners Can Be Improved} (June 2020).


\textsuperscript{37} TIGTA, Report No. 2020-40-014, \textit{Millions of Dollars in Discrepancies in Tax Withholding Required by the Foreign Investment in Real Property Tax Act Are Not Being Identified or Addressed} (March 2020).
period, TIGTA found that the IRS did not have a centralized compliance effort aimed at enforcing the expatriate rules.\textsuperscript{38}

Expatriates are required to file Form 8854, \textit{Initial and Annual Expatriation Statement}, to certify that they have been in compliance with all Federal tax laws during the five years preceding the year of expatriation. However, TIGTA found that the IRS database of expatriates was incomplete for 16,798 expatriates who did not file Form 8854. In addition, TIGTA found instances of potential nonfiling, underreporting of income, and/or payment compliance issues by expatriates. From a sample of 26 expatriates who did not file a Form 8854, five had potential unreported income over $6 million. From a sample of 61 expatriates who filed a Form 8854, 15 had potential unreported income over $17 million. Lastly, TIGTA also found that expatriates with high net worth appear to not be paying their exit tax.

We appreciate the opportunity to testify on the topic of the Tax Gap and the related IRS enforcement efforts. We plan to provide continuing audit, investigative, and inspections and evaluations coverage of these very important issues.

Chairman Whitehouse, Ranking Member Thune, and Members of the Subcommittee, thank you for the opportunity to share my views.

J. Russell George
Treasury Inspector General for Tax Administration

Following his nomination by President George W. Bush, the United States Senate confirmed J. Russell George in November 2004 as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the Inspector General of the Corporation for National and Community Service, having been nominated to that position by President Bush and confirmed by the Senate in 2002.

A native of New York City, where he attended public schools, including Brooklyn Technical High School, Mr. George received his Bachelor of Arts degree from Howard University in Washington, D.C., and his Doctorate of Jurisprudence from Harvard University's School of Law in Cambridge, MA. After receiving his law degree, he returned to New York and served as a prosecutor in the Queens County District Attorney's Office.

Following his work as a prosecutor, Mr. George joined the Counsel's Office in the White House Office of Management and Budget, where he was Assistant General Counsel. In that capacity, he provided legal guidance on issues concerning presidential and Executive Branch authority. He was next invited to join the White House Staff as the Associate Director for Policy in the Office of National Service. It was there that he implemented the legislation establishing the Commission for National and Community Service, the precursor to the Corporation for National and Community Service. He then returned to New York and practiced law at Kramer, Levin, Naftalis, Nessen, Kamin & Frankel.

In 1995, Mr. George returned to Washington and joined the staff of the Committee on Government Reform and Oversight and served as the Staff Director and Chief Counsel of the Government Management, Information and Technology Subcommittee (later renamed the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations), chaired by Representative Stephen Horn. There he directed a staff that conducted over 200 hearings on legislative and oversight issues pertaining to Federal Government management practices, including procurement policies, the disposition of Government-controlled information, the performance of chief financial officers and inspectors general, and the Government's use of technology. He continued in that position until his appointment by President Bush in 2002.
Mr. George previously served as a member of the Recovery Accountability and Transparency Board, which was established to provide oversight and transparency of spending under the American Recovery and Reinvestment Act of 2009. Mr. George currently serves as a member of the Pandemic Response Accountability Committee (PRAC). Established in March 2020 by the Coronavirus Aid, Relief, and Economic Security Act, the PRAC is a Committee of the Council of the Inspectors General on Integrity and Efficiency. The PRAC’s mission is to promote transparency and provide coordinated oversight of the Federal Government’s coronavirus response to prevent and detect fraud, waste, abuse, and mismanagement and mitigate major risks that cross program and agency boundaries.