United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510–6200

May 10, 2021

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

Dear Commissioner Rettig:

During an April 13 hearing before the Senate Finance Committee, you speculated that the "tax gap" could approach or possibly exceed $1 trillion per year.[1] On April 23, you published a document posted on the IRS website which elaborated on that speculation.[2] Some of the basis of your speculation subsequently appeared in an April 28 Fact Sheet on the White House website describing elements of the President's "American Families Plan."[3]

To summarize, you argue that: the most recent tax gap study by the IRS, covering tax years 2011-2013, identify a gross (net) tax gap of $441 ($381) billion; a lot has happened since those years, including the evolution of cryptocurrency markets with multi-trillion-dollar market capitalizations of assets; some recently released research and advocacy studies about unreported or concealed income offshore and in pass-through entities suggest possibly large, undetected tax-gap amounts; and, if you take into account cryptocurrency and the studies, "it would not be surprising if the noncompliance for tax years going forward exceeded $1 trillion, annually."[4]

While your testimony and writing makes clear that you are speculating about the $1 trillion figure, many have taken it as a factual data point. For example, on the day of the Senate Finance Committee hearing, the New York Times reported that, "Tax cheats cost the U.S. $1 trillion per year, I.R.S. chief says."[5]

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[1] Senate Finance Committee hearing, April 13, 2021, titled, "The 2021 Filing Season and 21st Century IRS," at https://www.finance.senate.gov/hearings/the-2021-filing-season-and-21st-century-irs .
[2] "A Closer Look: Impacting the Tax Gap," April 23, 2021, at https://www.irs.gov/pub/foia/ig/cl/tax-gap-for-web.pdf .
[3] "Fact Sheet: The American Families Plan," April 28, 2021, The White House, at https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/
[4] *See*, page 3 of "A Closer Look: Impacting the Tax Gap."
[5] "Tax cheats cost the U.S. $1 trillion per year, I.R.S. chief says," New York Times, April 13, 2021, at https://www.nytimes.com/2021/04/13/business/irs-tax-gap.html .

For Congress to make informed policy choices, it is of interest to learn about a decomposition of your aggregated tax-gap number, so please answer the following questions, and provide responses by May 24:

- How much of the possible $1 trillion current-year tax gap is attributable to growth in the dollar-value of the earlier estimated 2011-2013 net gap of $381 billion arising from asset and price growth since that earlier period[6];

- How much of the possible $1 trillion tax gap is attributable to cryptocurrency holdings and, given volatility in cryptocurrency valuations, how confident are you that your valuation for the current year should apply to future years[7];

- How much of the possible $1 trillion tax gap is attributable to what you say reflects unreported or concealed income offshore and in pass-through entities?

I look forward to working with you and the Administration in examining the efficacy of possible additional resources intended to collect more revenue from those who owe it. As you know, tax gap estimates have always drawn interest because there appear to be significant resources available from enhancing compliance. Yet, actually realizing those resources from enhanced IRS funding has not always proven easy or transparent.

Moreover, it has long been the case that so-called return-on-investment (ROI) numbers offered by federal agencies suggest high potential payoffs to resource investments, but the numbers are inherently speculative and ex-post confirmations of actual realized returns from investments are scarce. You identified that "…*any* (italics original) stated ROI is likely understated because it does not reflect the effect that visible, enhanced enforcement has on deterring non-compliance." It is troubling to hear that any ROI put forward by an agency is understated, since estimates with systematic biases are bad estimates. It is potentially concerning to hear that ROI estimates may be understated because the estimates do not account for how visible and enhanced IRS enforcement could affect taxpayer behavior. That suggests that greater invasiveness of the IRS could be useful for revenue generation.

There are also a number of questions related to a study that you and the Administration have heavily relied upon to urge greater funding for the IRS and greater targeted IRS scrutiny of some Americans.[8] That study involved use of sensitive private taxpayer data with strict legal protections on confidentiality, and evidently was performed in part by having the IRS arrange a

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[6] Any tax gap inference from indexing past values up or down using equity or price valuations must acknowledge that valuations are sensitive to cyclicality in economic outcomes.

[7] Any tax gap inference from cryptocurrency valuations must acknowledge volatility in those valuations; while, as you state, cryptocurrency assets have "…a current global market cap of almost $2 trillion…" note that while Bitcoin (BTC) was priced around $62,785 on April 15 of this year, last year's price on March 16 was $6,654. If the tax gap estimate arises at least in part from cryptocurrency valuations, then today's value may not be a good indicator of what to expect in the future.

[8] The study was published by the National Bureau of Economic Research (NBER), and is titled "Tax Evasion at the Top of the Income Distribution: Theory and Evidence," March, 2021; by John Guyton, Patrick Langetieg, Daniel Reck, Max Risch, and Gabriel Zucman, at https://www.nber.org/papers/w28542 .

special agreement to make IRS employees of two of the non-IRS researchers.[9] One of the authors has been actively crusading, with unclear policy objectives, to "tax the rich," proposes tracking everything people own in a "global wealth registry," and has worked on research that former Treasury Secretary Lawrence Summers has called "substantially inaccurate and substantially misleading."[10]

Unfortunately, the study you cite is not at this point a reliable source from which to make assessments about either the tax gap or the specific activities of "high-income and high-wealth taxpayers" toward which the IRS is shifting examination activity.[11] That same study has not been adequately vetted, and it is premature for the IRS to place such emphasis on its findings. Indeed, a subsequent analysis of that study, including commentary on the analysis employed by the study's authors, published on May 3, 2021, reports that there are: "methodological problems creating an inherent bias in their results;" incorrect approaches; methodological issues; and other problems.[12] Once addressed, those problems, according to the May 3 commentary, lead to a finding that "including evasion has much less impact on top income shares and that high-income underreporting rates are lower."

Given these issues, please respond to the following by May 24:

- In light of the commentary by authors Auten and Splinter, please make corrections you believe are necessary to the Guyton, Langetieg, Reck, Risch and Zucman analysis, and identify an updated official IRS assessment of the percentage of federal income taxes unpaid but owed by the top 1 percent, and how much collection of all of that would generate for the federal government, relative to the quoted $175 billion annually on page 3 of your "A Closer Look: Impacting the Tax Code" article.

- Please identify when you expect to respond to the questions I asked of you for the record following your April 13 testimony at the hearing before the Senate Finance Committee. I am appending a copy of those questions for your convenience.

There are useful, bipartisan issues worth pursuing regarding IRS funding, enforcement of our tax laws and taxpayer responsibilities, and the tax gap. I look forward to working with you and the Administration on those issues, ever mindful of the importance of protecting the rights and privacy of all taxpayers. It would be a lost opportunity if discussions and advocacy turn into political exercises, and it would be detrimental if IRS efforts do not strike the appropriate balance between taxpayer responsibilities and taxpayer rights.

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[9] Some of the authors of the study have advocated for additional IRS funding on social media following release of the IRS which was published in the NBER, though stopping slightly short of explicitly calling on the public to contact their representatives and advocate for added IRS funding.

[10] See "Would a 'Wealth Tax' Help Combat Inequality? A Debate with Saez, Summers, and Mankiw," October 18, 2019, sponsored by the Peterson Institute for International Economics, viewable at https://www.youtube.com/watch?v=oUGpjpEGTfE .

[11] Page 10 of A Closer Look.

[12] See "Comment: Tax Evasion at the Top of the Income Distribution: Theory and Evidence," May 5, 2021, by Gerald Auten and David Splinter, at http://www.davidsplinter.com/AutenSplinter-TaxEvasion.pdf .

Sincerely,

Mike Crapo

Ranking Member

Attachment: Questions for the Record