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Increasing IRS Tax Collection Powers Threatens More IRS Abuse: The New Congress Moves to Close the “Tax Gap”

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The House and Senate leadership may advance legislation this year to close the so-called tax gap, or the amount of taxes that government accountants say should be paid but is not. Some small progress toward this end can be made simply by tightening existing rules, according to a recently released Treasury Department study.¹ After all, only a small percentage of taxpayers intentionally fail to pay their taxes each year, while a much larger number make innocent reporting errors.

Major progress, however, will require one of two approaches: either a substantial expansion of IRS enforcement processes or fundamental tax reform that simplifies the overly complex tax code and reduces tax rates. The Treasury Department estimates that about 91 percent of the total tax gap is due to nonfiling of returns and underreporting of income.² Of the two, noncompliance due to underreporting is ten times larger than nonfiling, which Treasury accurately attributes to the enormously confusing tax code that Congress has created.³

Either approach will close the tax gap to a significant extent. Simplification and rate reduction assures greater compliance over the long term, as the taxpaying experience in country after country, when tax policy is changed to reduce confusion and rates, proves.⁴ Unleashing the IRS on honest taxpaying families who are confused about their tax obligations may give Congress more revenue in the short run, but it comes at the cost of vastly expanded legal tax

avoidance schemes and taxpayer resistance in the long run, thus reducing revenues. It also means further losses of individual liberty in an age when liberties in so many other areas are declining.

If, as expected, the majority party in Congress chooses police power over good tax policy and increases compliance through more audits, more investigations of taxpayers, and more penalties, the new congressional leadership will have set the stage for a resurgence of abusive behavior by the IRS. Because that appears to be the likely outcome of this season's tax gap campaign, it is important to review what the Senate Committee on Finance heard about the history of IRS illegal activity and taxpayer abuse in a stunning, three-day winter hearing in 1998.

Some context: The Republicans won the election of 1994 and the congressional majority, in part on promises to rein in the IRS and reform the tax code. By 1997, most members of the Republican caucus in the House and Senate (and many in the Democratic Party) were smarting under increasingly sharp taxpayer complaints of IRS abuse. The Senate Finance Committee hearings in 1998 were designed

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to publicize that abuse and spark much-needed reforms of IRS practices.

The Finance Committee focused primarily on the Collection Division, which is charged with making certain taxpayers send to Washington exactly what the IRS believes they owe. In today's jargon, the hearings focused on abusive behavior that stemmed in part from the IRS's efforts to close the "tax gap."

For those old enough to remember the news coverage, what stands out is the image of IRS agents testifying behind translucent screens and talking through voice alteration mixers. These whistleblowers so feared reprisals from their own colleagues that they could not show their faces in a hearing of a Senate committee. Here's why:

Anonymous Agent #1 testified that over his long career in collections he had seen senior IRS staff and executives "violate or ignore Internal Revenue Manual procedures and Treasury regulations simply because they wanted to punish a taxpayer. . . . I have seen more violations of IRS procedures and policies than I can count. The most appalling aspect of the foregoing examples is that in most every instance, IRS management supported the erroneous actions of the Revenue Officer."⁵

Anonymous Agent #2 testified that "[o]ver my 20 years of service, I have become painfully aware of the ability of the IRS to retaliate against employees who dare to speak out. Many of the witnesses you will have before you in this hearing [sic] could be retaliated against for their testimony before this Committee. At times, I have been assigned an employee case and been told that management does not like that employee, and I have been told that I need to find something that they can use to terminate their employment. In the IRS, retaliation is swift and severe. I hope you will respect the risk that these witnesses took to appear before you, and protect them from any act of revenge by IRS management."⁶

Anonymous Agent #3, another long-serving employee of the IRS, testified that he had seen "[t]ax data being accessed by IRS employees to check on prospective boyfriends; [t]ax data being accessed by IRS employees to check ex-husbands for increasing income in order to receive increased child support payments; [t]ax data being accessed on people with whom IRS employees were having some kind of personal disagree-

1. A U.S. Department of the Treasury report on tax compliance issued in September 2006 contains the Bush Administration's proposals for reducing noncompliance. See U.S. Department of the Treasury, Office of Tax Policy, "A Comprehensive Strategy for Reducing the Tax Gap," September 26, 2006, at www.treas.gov/press/releases/reports/otptaxgapstrategy%20final.pdf (February 22, 2007). Table 2 of this report contains estimates of the components of the tax gap. Non-filing and underpayment account for 18 percent of the total. The Treasury Department subsequently refined its proposals and summarized them in the President's budget submission for fiscal year 2008. See Office of Management and Budget, *Fiscal Year 2008: Analytical Perspectives* (Washington, D.C.: U.S. Government Printing Office, 2007), pp. 261-263, Table 17-3: Effect of Proposals on Receipts. The Administration estimates that its proposals will reduce noncompliance by \$29.5 billion over the ten-year period from 2008 through 2017. That cumulative amount is 0.09 percent of forecasted federal revenues without the policy changes and about 1 percent of the cumulative "tax gap" over that same period. For total forecasted revenues, see Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2008 and 2017*, January 2007, Table 1-3, p. 8, at www.cbo.gov/ftpdocs/77xx/doc7731/01-24-BudgetOutlook.pdf (February 22, 2007).
2. Office of Tax Policy, "A Comprehensive Strategy for Reducing the Tax Gap," p. 7, Table 2.
3. *Ibid.*, p. 15.
4. Australia, for example, simplified its tax code and reduced tax rates to enhance tax compliance. See Gus O'Donnell, "Financing Britain's Future: Review of the Revenue Departments," HM Treasury, at www.hm-treasury.gov.uk/media/DDA/BC/odonnell_ch3_260.pdf.
5. "Prepared Statement of Witness Before the Senate Finance Committee Oversight Hearing on the Internal Revenue Service, Thursday, September 25, 1997," Anonymous #1, at <http://enzi.senate.gov/theirs.htm> (February 22, 2007).
6. "Prepared Statement of Witness Before the Senate Finance Committee Oversight Hearing on the Internal Revenue Service, Thursday, September 25, 1997," Anonymous #2, at <http://enzi.senate.gov/theirs.htm> (February 22, 2007).

ment;... [t]ax data being accessed on individuals who are perceived as critical of the IRS, such as tax protestors or, as in one case, a person who had simply written a Letter to the Editor.... [t]ax data being accessed on relatives and acquaintances of the subject taxpayer, such as cases where the taxpayer is suspected of using friends and relatives to hide income or assets; [t]ax data being accessed on potential witnesses in government tax cases; [t]ax data being accessed on jurors sitting on government tax cases.”⁷

One particularly noteworthy non-agent witness, official IRS historian Shelley Davis, testified to one of the most spectacular periods of IRS abuse in the agency’s history: the period between 1969 and 1973 when the Special Services Staff compiled tax information on about 11,000 Americans that the Nixon Administration believed were its enemies. As Davis noted:

Ten employees of the SSS dutifully clipped newspaper articles each day. The FBI willingly sent over its own files on political dissidents and protesters, and subscriptions were taken to radical publications which were perused for names and other leads. All in all, the SSS targeted individuals with no known tax problems for audit simply because of their political activities.

She also testified that she believed that the list still existed, though she also believed that no one at the IRS continued to maintain it.⁸

As author and journalist David Burnham testified, IRS abuses were nothing new. Indeed, when

Administrations as far back as Herbert Hoover’s empowered the agency to be especially aggressive collecting taxes, significant abuse of taxpayer privacy and fundamental law ensued. Franklin Delano Roosevelt “ordered the agency to mobilize its enforcement powers against former Treasury Secretary Mellon, Senator Huey Long, the singer Paul Robeson, Republican Representative and neighbor Hamilton Fish, Father Charles Coughlin and many others.” During the Kennedy years, the IRS was unleashed to go after “extremist organizations.” Burnham noted, however, that:

Although the memos describing the program said the extremists of concern were on both the right and the left, it appears that all of those who lost their tax exempt status in connection with this program were fundamentalist conservatives who had been criticizing the president.⁹

The Senate Finance hearings led Congress and the IRS to make a number of reforms that reined in abusive collection agents and overzealous political operatives. Taxpayers are safer today than they were in 1998.

But the history of the agency shows that this is a fragile peace. The record of abuse points to one crucial lesson: Strengthening the police powers of the IRS should be the very last step taken to collect more revenues. If Congress ignores that lesson, it may find itself one day again listening to testimony on IRS abuses from witnesses hidden by translucent screens and voice alteration mixers.

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7. “Prepared Statement of Witness Before the Senate Finance Committee Oversight Hearing on the Internal Revenue Service, Thursday, September 25, 1997,” Anonymous #3, at <http://enzi.senate.gov/theirs.htm> (February 22, 2007). Other agents testified in a similar vein about patterns of abuse and disregard for the law.
8. “Prepared Statement of Shelley L. Davis Before the Senate Finance Committee Oversight Hearing on the Internal Revenue Service, Tuesday, September 23, 1997,” at <http://enzi.senate.gov/theirs.htm> (February 22, 2007).
9. “Prepared Statement of David Burnham Before the Senate Finance Committee Oversight Hearing on the Internal Revenue Service, Tuesday, September 23, 1997,” at <http://enzi.senate.gov/theirs.htm> (February 22, 2007).