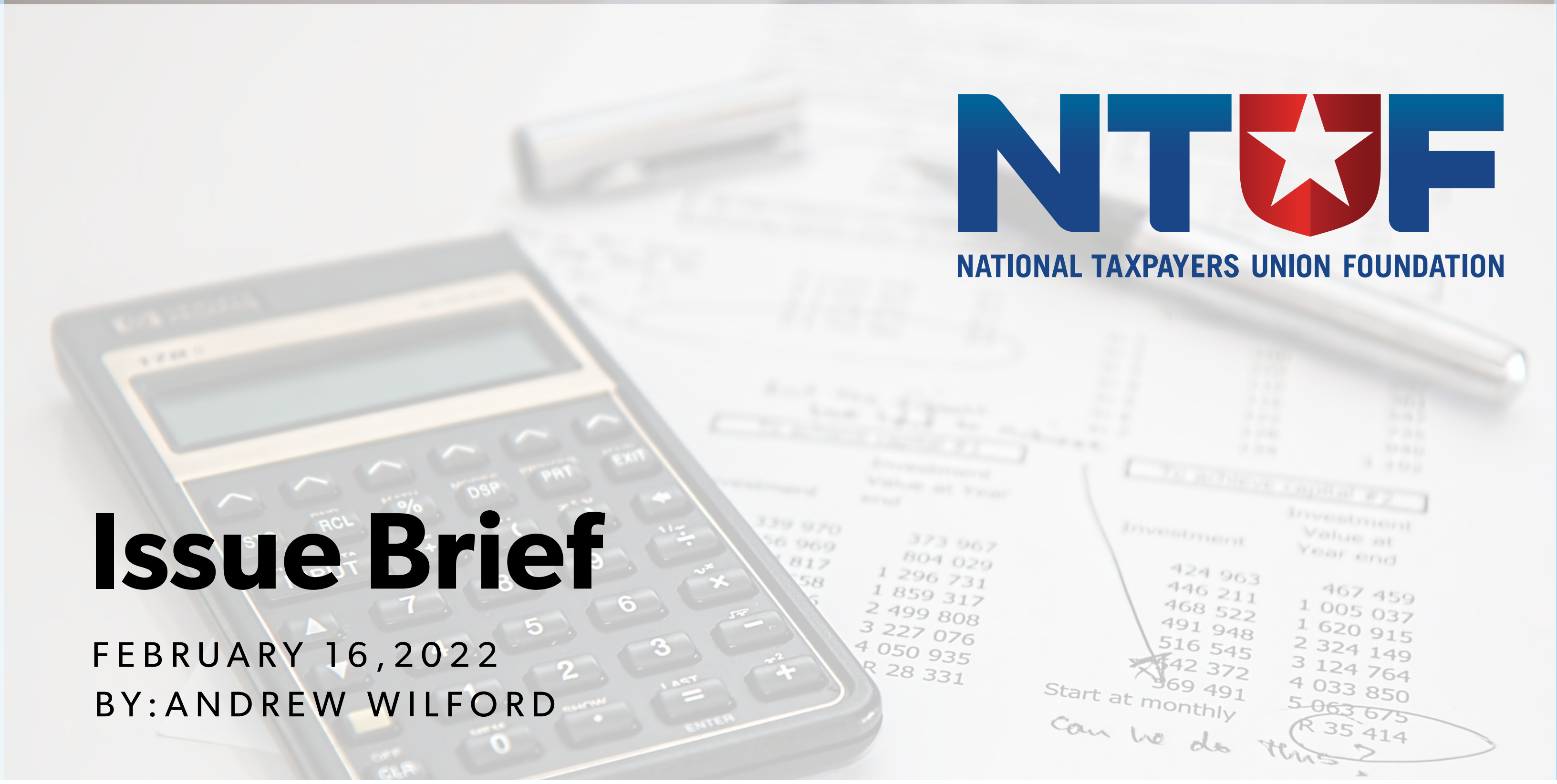

NATIONAL TAXPAYERS UNION FOUNDATION

Issue Brief

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IRS Scrutiny Is Not Only a Concern for Tax Evaders

Ever since Democrats have begun seeking out new sources of revenue to "pay for" their proposed reconciliation bill, a heavy focus has been placed upon cracking down on "tax cheats." Originally sparked by eyebrow-raising estimates of the size of "tax gap," or the gap between what the IRS collects and what it believes taxpayers owe, belief in a massive untapped source of revenue has given rise to proposals which would entail significant intrusions upon taxpayer privacy.

While related proposals to boost the IRS's enforcement budget by $80 billion over the next ten years and hire tens of thousands of new agents are perhaps more grandiose, the most potentially invasive form that these efforts have taken has been the proposal to require financial institutions to report information on their customers' bank accounts to the IRS. The idea is that the IRS could then use this information to compare against reported income and catch tax evaders who attempt to hide income. And while these proposals have faced backlash, their key proponents, including Treasury Secretary Janet Yellen, remain determined to push to have them enacted into law.

Targeted at the Wealthy?

But while the Treasury Department has repeatedly claimed that the goal of such proposals is to target individuals with incomes above $400,000, taxpayers have long had reason to be skeptical.

Key Facts:

As the IRS continues to struggle to fulfill its most basic responsibilities of processing tax returns and assisting taxpayers in filing their taxes, some members of Congress continue to contemplate a scheme to give the IRS access to taxpayers' private financial information.

However, past experience with IRS leaks, as well as government agencies' unfortunate history of using "civil asset forfeiture" to line their pockets, suggests that the agency cannot be trusted with this kind of information.

Congress should direct its attention first to shoring up the IRS's safeguards of taxpayer data and ensuring it can meet its most basic responsibilities before considering new enforcement powers.

Even as the proposal has changed over time, it has remained likely to catch millions of average taxpayers in its dragnet.

The original proposal would have required financial institutions of all kinds to report gross inflows and outflows for any account that exceeds $600 in cash flow over the course of a year. This was met with immediate backlash, as just about any account would exceed this threshold, with the possible exception of a child's starter savings account (so long as they aren't particularly enterprising with their lawn mowing or lemonade stands that year!)

Attempts to address these concerns led to a modified proposal, with the threshold raised to $10,000 and payroll deposits and outflows up to the level of those payroll deposits exempted. In other words, a taxpayer with $40,000 in payroll deposits would have to spend over $50,000 that year in order for their account to be subject to the reporting requirement.

NTUF was skeptical that that would address the issue at the time, pointing out numerous examples of average taxpayers who could still meet this threshold. Anyone from small business owners who withdraw funds from the business as needed to freelancers to tipped workers and many more could conceivably still end up with income outside of payroll deposits or spending well above that level.

Since then, official estimates have backed this up. The Joint Committee on Taxation estimated that 87 million taxpayers with less than $400,000 in adjusted gross income (AGI) would be subject to the reporting requirement — or 59 percent of all taxpayers.

Skepticism of the IRS Is Justified

But even aside from the particulars of the proposal, the IRS has given plenty of reason to be suspicious that it would contain itself to cracking down on wealthy tax cheats. There is a long and well-documented history of government monitoring of financial matters being targeted at average Americans performing innocuous activities.

The most direct parallel comes in the form of civil asset forfeiture. Traveling domestically with large amounts of cash is not illegal, yet law enforcement officials often deem such activity to be suspicious and seize the cash. Take the examples of a woman flying home to put her father's life savings of $82,373 in a bank account or two Vietnamese immigrants driving with over $100,000 to buy a plot of farmland. In both cases, the cash was seized despite the fact that the persons involved were doing nothing illegal.

And while these are two specific examples, civil asset forfeiture is disturbingly widespread. In 2014, in fact, the $5 billion seized under civil asset forfeiture greatly exceeded the $3.5 billion lost to burglary. Under one estimate, 85 percent of those who had their cash seized were never charged with a crime.

That's plenty of reason for civil asset forfeiture reform, but in the meantime, it's all the more reason to be skeptical of handing over information on taxpayers' bank accounts to the federal government. Though the IRS would only be able to access gross inflows and outflows from Americans' bank accounts under the proposal, anything the IRS deems "suspicious" would give it the ability to demand further information under the threat of an audit.

There are plenty of potential cases where innocuous activities could result in taxpayers being harassed by the IRS, or even law enforcement seizure of assets. Under this proposal, even had the above woman succeeded in getting home without law enforcement seizing her father's savings, she would surely get trouble from the IRS demanding an explanation of where she got the $82,373 to open a new bank account in her father's name.

And that's not the only reason to be skeptical of the IRS's beneficence. As NTUF has noted in the past, the IRS estimates that at least 20 percent of Earned Income Tax Credit (EITC), Child Tax Credit, and American Opportunity Tax Credit payments are made improperly. These are all predominantly claimed by low-income taxpayers, and any effort to close the tax gap would necessarily result in a crackdown on improper credit payments.

Even as things stand, audits tend to focus on low-income taxpayers. Investigative outlet *ProPublica* found that while 1.6 percent of taxpayers in the top 1 percent by AGI were audited, EITC recipients were audited at a not-much-lower rate of 1.4 percent. Audits of EITC claimants accounted for 36 percent of all audits that the IRS conducted.

It's naive to imagine that any increase in financial disclosure or enforcement funding would reduce the number of audits that low-income taxpayers face. Refundable credits are prone to abuse and even honest mistakes, and more enforcement capacity would only empower the IRS to seek out more improper payments.

Conclusion

As Build Back Better remains in limbo, so too do proposals to expand the scope of IRS enforcement capabilities. After all, as it stands, the IRS has hardly shown that it is capable of performing the duties it is already entrusted with.

Yet even were it capable of processing vast amounts of new information on taxpayers, the truth is that the IRS has not earned the trust that it is asking for. Taxpayers are rightly suspicious that further financial disclosure would earn only more harassment, audits, and even cash seizures even among those who do everything right. Until the IRS can prove that it can act as a responsible steward of the information it is already entrusted with, it certainly does not deserve even more.

About the Author

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