THE ASSOCIATION OF AMERICANS RESIDENT OVERSEAS

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Senate Committee on Finance
Attn. Editorial and Document Section
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Hearing on "Closing the Tax Gap: Lost Revenue from Noncompliance and the Role of Offshore Tax Evasion", Tuesday, May 11, 2021

Submission by the Association of Americans Resident Overseas to the U.S. Senate Committee on Finance, Sub-committee on IRS Oversight

The Association of Americans Resident Overseas (AARO) is a Paris-based Association representing more than 1000 American members living outside the United States. We welcome the opportunity to comment on administration plans to raise large sums by reducing the $381-billion net "tax gap" (14.2 % of "true taxes owed"). We understand that the IRS will likely revise upward its estimate of the tax gap, in part due to the large role attributed to offshore tax evasion.

We fully appreciate the need to modernize computing and information systems at IRS, something which AARO agrees should have been done long ago[1]. -We also strongly urge that some of the large budgetary increases planned for the IRS be used to fund major improvements in taxpayer services accessible to overseas Americans. These include the creation of a dedicated division whose mandate includes providing customer service to taxpayers outside the U.S., online accounts, video-conferencing, facilitating payments both to and from IRS and use of foreign languages.

At the same time, the substantial increase in funding for the IRS proposed by the administration of around $8 billion per year for the next decade (an increase on the order of 60-70%)[2] raises a concern that, if its use is not properly structured, it may prove to be wasteful or even damaging. The emphasis on presumed but unidentified offshore evasion is particularly worrying to AARO given the problems existing enforcement efforts, relying heavily on foreign banks, have created for Americans overseas trying to access their local financial system. Rapidly diminishing returns to

[1] See the various Annual Assessments of IRS' Information Technology Program by the Treasury Inspector General for Tax Assessment (TIGTA) and reports from the Government Accountability Office (GAO) such as "Identity theft: IRS Needs to Strengthen Taxpayer Authentication Efforts" [GAO-18-418]; and "Information Technology: IRS Needs to Take Additional Actions to Address Significant Risks to Tax Processing" [GAO-18-298].

[2] For comparison, IRS resources in the Continuing Resolution for FY 2019 were $11.2 billion from appropriations ($4.7 billion for enforcement) plus $1.1 billion from other sources, mainly user fees.

increases in expenditures seem inevitable, even given careful design of new enforcement measures.

The administration is targeting very high-income people assumed to be skilled at large-scale evasion, especially offshore. No one is deliberately targeting ordinary expats whose demographics and financial means are much like those of domestic American taxpayers across the entire socio-economic scale. But our experience is that legislation and regulations are too often rushed and/or designed without consideration of their harsh, usually unintended, real-world impact on non-resident citizens. Recent examples include the deprivation of local bank accounts due to application of the Foreign Accounts Tax Compliance Act (FATCA); abusive and arbitrary resort to passport suspension and revocation; punitive tax penalties for small American businesses located outside the U.S. under the 2017 tax law's Transition Tax; and the levy on Global Intangible Low-taxed Income (GILTI) are recent examples.

We have seen the IRS submission for this hearing and have obtained the research it released though the National Bureau of Economic Research (NBER).[3] This describes the methodology it has used in the past for calculating tax gaps as well as its basis for new estimates that will reflect an offshore component. A virtue of the NBER paper is that it includes clear, transparent and robust evidence-based analysis, derived mainly from the large National Research Program (NRP) of random audits:

- Income under-reporting is 4% of the total, and the related tax deficiency is 7.7%.
- Just under 40% of this tax deficiency is owed by the top 10%.
- The total "net" tax gap (i.e., taking all types of federal tax into account, net of enforcement and late payments) was around $193 billion p.a.[4]
- Adjusting for growth and inflation since 2012 yields a current estimate around $282 billion.

We are still digesting this work, but the gap between these numbers and more widely reported headline figures running to $1 trillion[5] seems to consist almost entirely of "adjustments" that are at best highly speculative guesswork. We can find little basis in evidence for these "adjustments," labelled variously "less sophisticated" and "sophisticated" evasion ("sophisticated" includes the offshore component, as well as evasion by many small businesses). Hopefully the referees who peer-review this work will be well-versed in international banking analysis and provide guidance to assist IRS toward well-targeted and realistic deployment of its coming resource increases

[3] Guyton, J; P. Langetieg; D. Reck ; M. Risch ; and G. Zucman (2021), "Tax Evasion at the Top of the Income Distribution: Theory and Evidence". NBER Working Paper 28542, http://www.nber.org/papers/w28542 .

[4] The $381-billion total "net gap" estimate is for 2011-13. The NBER study covers 2006-13 but describes the numbers relating to under-reporting in the two studies as "essentially identical" (p.9). On this basis, we proceed on the basis that we can adjust the former on the basis of adjustments to the latter alluded to in our following paragraph.

[5] Including the 2011-13 $441-billion gross and $381-billion net tax gaps, the estimate that the gap had risen to c. $600 billion in 2019, all cited in the IRS submission, and Commissioner Rettig's widely reported testimony to the Senate Finance Committee in April.

While IRS methodology may be deemed the gold standard internationally, as the IRS submission states, other countries also prepare useful estimates of their own tax gaps. Notably, the latest tax gap reported by HM Revenue and Customs (HMRC) for the United Kingdom was 4.7% of "tax liabilities"[6]. This is just 1/3 of the 14.2% U.S. net tax gap. Offshore evasion plays no explicit role in the analysis, and evasion attributed to the "wealthy" is below levels suggested by NRP audits, i.e., even before "adjustments", in the United States.

This raises the question as to why the tax gap is so much lower in the United Kingdom? One possibility is that the tax system is simpler and more coherent and allows better coverage of tax bases by easily administered collection points and third-party reporting. In this case the solution to the tax gap is not more enforcement but major tax reform. Another possibility is that HMRC carries its duties out more efficiently than does the IRS, in which case the IRS might usefully learn from its British counterpart. The third possibility is that the difference lies in the respective capacities and methodologies of the two agencies for measuring tax gaps, in which case one should be able to learn from the other. Investing $20,000 for an independent expert to review IRS methodology, report on the reasons for the much smaller British tax gap and suggest lessons that can be drawn might be a good use of government money before $80 billion are deployed to mine an uncertain tax gap.

Finally, as noted above, there has been a long track record of hasty legislation and poorly targeted rules that have inadvertently done great damage to American citizens who happen to live overseas. AARO strongly urges the IRS (and its congressional overseers) to take care to ensure that the rules and procedures to be used by the IRS, especially where it targets offshore evasion, be subject to far more careful and meaningful regulatory impact assessments than have been carried out in the past. Unintended assaults on large numbers of compliant, law-abiding, working class, middle class and retired Americans who are not part of the top 1%, as well as small businesses, must be avoided.

AARO is available to Finance Committee members and their staff, and would welcome the opportunity, to elaborate on any of the citations or commentary provided above.

Thank you for your attention.

Paul Atkinson
Chair, Banking Committee

Fred Einbinder
Vice-President, Advocacy

William Jordan
President

[6] "Measuring Tax Gaps, 2020 Edition", HRMC. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/907122/Measuring_tax_gaps_2020_edition.pdf. See p.5 for a summary..