An Overview of the “Tax Gap”

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I. INTRODUCTION

“Bad things happen if you fail to pay federal income taxes when due.”1 Although the Supreme Court was referring to the calamities that befall taxpayers,2 the same can be said for the government. Some “taxpayers”3--intentionally or unintentionally--fail to report and/or pay the proper amount of tax owed when due. Accordingly, the government must spend money to audit taxpayers, to assess taxes, to collect the proper amount of tax due, and to borrow to replace the lost revenue. Additionally, taxpayer failures to comply with the tax law--i.e., the Internal Revenue Code (the Code)--foster a lack of public confidence in, and feelings of unfairness about, the Code and those charged with enforcing it.4 This, in turn, may lead additional taxpayers to not comply with the Code.5

The “tax gap” represents the annual amount of “noncompliance” with the Code.6 The estimated tax gap for tax year 2001, the most recent year available, is $345 billion.7 Noncompliance takes three forms: (1) underreporting ($285 billion--82 percent of the tax gap); (2) underpayments ($33 billion--10 percent of the tax gap); and (3) non-filing ($27 billion--8 percent of the tax gap).8

The tax gap does not arise solely from evasion or cheating. This fact, however, often is misunderstood.9 The misconception is that the tax gap is due, in part, to taxpayers taking advantage of “loopholes.”10 The tax gap, however, does not arise from taxpayer “exploitation” of intended or unintended benefits of the Code--if a tax position/strategy is legal, a taxpayer using such a tax position/strategy is not underreporting or underpaying taxes due and owing.11
Furthermore, the tax gap is not only made up of the underground economy (income from illegal activities, payments made in cash to avoid withholding and reporting requirements, etc.). Although there may be overlap between the tax gap and illegal behavior, they are not synonymous. Noncompliance may be intentional (e.g., deliberately underreporting income), unintentional (e.g., underreporting income because the taxpayer did not understand that the amount was income, calculating a credit that is confusing and/or complex, or inadvertently claiming the incorrect filing status), or both.

One reason to reduce the tax gap is to correct the inequity it creates among taxpayers: taxpayers who are compliant bear a greater burden that those who are noncompliant.12

Now, what do honest, law-abiding taxpayers expect in return [for paying their taxes] from the government? They expect that, if they are honoring their legal obligation to truthfully and accurately file their returns and pay their taxes, their neighbors on their right and their neighbors on their left are going to do so as well. And if they don’t, they expect the government to enforce tax laws equally on everyone. One of the greatest challenges to tax compliance is the perception, today and in the past, that everyone may not be paying their fair share of taxes.13

This article describes the scope and causes of the tax gap and examines the various methodologies available to reduce the tax gap. Part II sets forth background information about the tax gap. Part III considers the role enforcement plays in reducing the tax gap. Enforcement is the methodology the Internal Revenue Service (IRS) currently employs, and that the George W. Bush administration (current administration) promoted, to reduce the tax gap. Enforcement, as explained infra, is insufficient and ineffective in and of itself to significantly reduce the tax gap. This is due in part to the complex and various causes and forms of the tax gap. Additionally, the methodologies available to reduce the tax gap are numerous--there is no single or simple way to reduce or eliminate the tax gap. Accordingly, part IV examines methodologies other than
enforcement to reduce the tax gap. These methods include increased information reporting, additional research, improved technology, shaming, international coordination and cooperation, simplification, and publishing more guidance. Part V concludes that a synergized, multi-pronged approach—simultaneously combining enforcement with more information reporting, additional research, improved technology, more publicity, enhanced international cooperation, simplification of the tax law, more published guidance, and rethinking how the collection function prioritizes debt collection—is the best methodology for reducing the tax gap. Accordingly, Congress, the next administration, and the IRS will need to work together to promote and to use several methodologies, including but not limited to enforcement, to reduce the tax gap.

II. BACKGROUND ON THE TAX GAP

Although the U.S. tax system has one of the highest rates of voluntary compliance in the world, the tax gap has transformed from a relatively obscure statistic to a focal point of Congressional and IRS action. The IRS has devoted an entire section of its web site to the tax gap—in English and Spanish. Additionally, Nathan Hochman, the new Assistant Attorney General for Tax, U.S. Department of Justice, has stated “My main priority is to fully and fairly enforce the civil and criminal tax laws. . . . Our commitment to this work goes a long way toward reducing the tax gap -- which is a significant priority for this administration.”

The IRS previously used the Taxpayer Compliance Measurement Program (TCMP) to estimate the tax gap. As part of the TCMP, the IRS engaged in line-by-line examinations of numerous tax returns. The last TCMP was for the 1988 tax year. The TCMP was eliminated
because members of Congress objected to its cost and the compliance burden it placed on taxpayers selected for TCMP audits.\textsuperscript{22}

The IRS replaced the TCMP with the National Research Program (NRP) to estimate the tax gap.\textsuperscript{23} The NRP was designed to minimize the compliance burden placed on taxpayers selected in the NRP sample.\textsuperscript{24} The NRP methodology consisted of three major processes: (1) case building--creating information files on returns selected for the NRP sample; (2) classification--using that information to classify the returns according to what, if any, items on the returns cannot be verified without additional information from the taxpayers; and (3) taxpayer audits limited to those items that cannot be independently verified.\textsuperscript{25}

Current research estimates that the voluntary compliance rate is approximately 84 percent.\textsuperscript{26} Senate Finance Chairman Max Baucus wants the Treasury Department to develop a plan to increase the compliance rate from 84 to 90 percent.\textsuperscript{27} Raising voluntary compliance by 1 percent equals an additional $25 billion in tax collected each year.\textsuperscript{28} Accordingly, the 6 percent increase that Senator Baucus seeks equals an additional $150 billion in tax collected each year.\textsuperscript{29} According to the National Taxpayer Advocate’s office, if the IRS eliminated the tax gap--i.e., if each noncompliant taxpayer complied with the tax laws--then each compliant taxpayer (who pays what he or she owes) could receive a check for approximately $2,500 from the government.\textsuperscript{30} In other words, compliant taxpayers (who file their returns and pay the correct amount of tax owed when due) subsidize noncompliant taxpayers in the amount of $2,500 per compliant taxpayer per year.

Compliance corresponds to whether the taxpayer’s activities are subject to withholding and information reporting requirements.\textsuperscript{31} Compliance is approximately 99 percent when
taxpayers are subject to withholding and information reporting requirements (e.g., wage earners), approximately 91 percent when taxpayers are subject to information reporting requirements (e.g., independent contractors), and approximately 46 percent when taxpayers are not subject to withholding or information reporting requirements (e.g., self-employed individuals). Accordingly, the lack of third-party information reporting requirements presents the greatest opportunity for noncompliance, and taxpayers whose income is not subject to information reporting compose the largest single portion of the tax gap.

III. ENFORCEMENT

During the last several years, tax prosecutions have been rising. Improving compliance is crucial in reducing the tax gap and maintaining the integrity of the voluntary tax compliance system. Despite IRS efforts to improve enforcement, the U.S. Government Accountability Office (GAO) continues to include tax noncompliance as one of twenty-six high-risk areas in the Federal Government.

A. Congressional Call to Action on the Tax Gap

The tax gap has been heavily publicized; as a result public officials have emphasized increased enforcement of tax laws in order to raise revenue. Congress is abuzz with hearings and legislation to reduce the tax gap. This activity reflects the government’s current need to raise revenue (in the face of several tax rate cuts and steep budget deficits incurred by the current administration). Additionally, reducing the tax gap is “low hanging fruit.” Eliminating the tax gap has common ground politically and Congress views it as an easier way to raise revenue and lower the deficit, as compared with raising taxes.
Congress also believes that the IRS needs to create (or re-create) a “fear factor” among taxpayers. Congress wants more aggressive action on reducing the tax gap. In 2006, the IRS hired 3,000 enforcement workers, and the fiscal year 2008 budget included an additional $440 million for IRS enforcement.

B. Executive Branch Enforcement Efforts

Only a couple of weeks into his tenure, the new IRS Commissioner Douglas Shulman stated that the IRS “need[s] to have rigorous enforcement programs” and a major objective of the IRS under his tenure “will be to reduce the tax gap through continued emphasis on strong compliance programs.” For example, compare fiscal year 2001 to fiscal year 2006. Since fiscal year 2001: (1) there has been a 77 percent increase in audits of individual returns, and an 18 percent increase in high income audits; (2) audits of individuals with income greater than $1,000,000 increased by approximately 85 percent; (3) audits of corporations with income greater than $10,000,000 increased approximately 19 percent; and (4) audits of corporations with income greater than $250,000,000 increased 30 percent.

Enforcement numbers are increasing in all categories. The government is targeting corporate fraud, employment tax, and “abusive” tax schemes as a means to reduce the tax gap. In 2008, 30 percent of IRS audits will cover employee classification issues. IRS scrutiny of wealthy individuals will be aggressive as the IRS is urged on by Congress to go after the “big guys.” Congress, however, wants “small cases” ($50,000 or less) to be examined and prosecuted too.

The current administration’s increased spending on enforcement, however, has resulted in (1) frozen spending on taxpayer assistance and services and (2) decreased funding for
modernization and improving technology.\textsuperscript{53} Funding for enforcement over the fiscal year 2004 through fiscal year 2008 period increased by 19.4 percent while funding for taxpayer services decreased by 3.8 percent.\textsuperscript{54} There is, however, no reliable data showing that more enforcement rather than more taxpayer service increases compliance.\textsuperscript{55}

\textbf{C. IRS Collection Activities}

The IRS “is making a mistake in [primarily attempting to collect] the highest dollar cases.”\textsuperscript{56} The average fresh/new debt in the IRS’s collection inventory is $3,000 for businesses and $10,000 for individuals.\textsuperscript{57} All of the debt in the IRS’s collection inventory is manageable for taxpayers to pay off in full via an installment plan if the IRS got to the taxpayer on “‘day one’.”\textsuperscript{58} The IRS, however, places fresh debt into a queue and works the highest dollar cases first.\textsuperscript{59} The IRS allows the fresh “collectable” debt to sit and accrue penalties and interest until the tax liability is so large that many taxpayers cannot afford to pay the amount owed when the IRS seeks to collect it.\textsuperscript{60} A problem exists in that a significant number of accounts in the IRS collection inventory (the queue) may never be worked, the amount owed on accounts (approximately $35 billion) and the number of taxpayers (866,777) in the queue were each at a ten year high as of fiscal year 2007, and the amount of taxpayer delinquent accounts is outpacing taxpayer accounts closed.\textsuperscript{61} Additionally, from fiscal year 2001 through fiscal year 2007, although the IRS removed approximately 7.5 million accounts with balances due totaling approximately $31 billion from the queue these accounts may never be worked.\textsuperscript{62} In late 2006, the IRS assigned collection cases that the IRS was not going to work to private collection agencies; however, this program only netted approximately $11 million after subtraction of the cost of this program.\textsuperscript{63}
D. International/Offshore Concerns

A key area in the current global economy is international tax enforcement and evasion. An estimated $50 to $100 billion (15 to 30 percent) of the $345 billion tax gap is due to offshore tax haven and tax shelter abuses. Additionally, the median “return” (additional tax assessed) on offshore tax evasion audits is approximately three times larger than other types of audits if the examination runs more than three years, and approximately twenty times larger than other types of audits if the examination runs four to five years. There are certain problems, however, associated with offshore tax evasion audits. These examinations can take approximately 500 days longer than a domestic audit, which can cause the years in issue to run up against the period of limitations. Additionally, offshore audits can come to a premature end, or not start at all, because (1) of the lack of withholding and/or reporting requirements, (2) IRS agents can be reprimanded if unpaid taxes are lower than originally expected/projected, and (3) IRS agents retire, leave the IRS, or get reassigned.

“Everyone is entitled to conduct their financial affairs in privacy but [foreign] secrecy laws which facilitate tax evasion are completely unacceptable.” Currently there is “an increase in the use of international vehicles with the goal of hiding taxpayers”. Enforcement against “individual offshore tax evasion represents a priority to the Tax Division [of the U.S. Department of Justice].” The Senate Finance Committee is investigating the use of offshore financial arrangements to conceal taxable income. Currently “[o]ffshore tax avoidance and evasion are high priorities for the IRS,” and the IRS is “determined to protect the United States tax system from abuse and ensure that taxpayers pay what they owe.” In 2008, international (offshore) tax evasion made IRS’s “Dirty Dozen” list.
International cooperation and enforcement is increasing\textsuperscript{75} to prevent cross-border tax shelters\textsuperscript{76} and to focus on such issues as transfer pricing, movement of intangibles, repatriation, and the foreign tax credit.\textsuperscript{77} Foreign athletes and entertainers are the subject of greater IRS scrutiny.\textsuperscript{78} Additionally, since the IRS took over enforcement of filing Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), in 2004, it has been preparing to increase FBAR enforcement.\textsuperscript{79}

Recently, Congress began investigating data showing billions of dollars in taxable assets hidden in Liechtenstein.\textsuperscript{80} “The events in Liechtenstein ‘once again demonstrate the problems presented by secrecy jurisdictions and tax havens that enable individuals to hide assets and evade taxes’”.\textsuperscript{81} It appears that “many U.S. citizens have also hidden assets [in Liechtenstein], which is a real injustice to the millions of working families in this country who honestly pay their taxes every year.”\textsuperscript{82} The IRS has initiated more than 100 enforcement actions, investigating “very specific information,” against U.S. taxpayers in connection with Liechtenstein bank accounts to ensure proper reporting and payment of taxes owed.\textsuperscript{83}

Furthermore, GAO is sending investigators to the Cayman Islands to probe U.S. businesses that may be trying to avoid paying taxes by setting up offices or subsidiaries offshore.\textsuperscript{84} A single five-story building in the Cayman Islands, which is listed as the address used by thousands of companies, is at the heart of this investigation.\textsuperscript{85} The purpose of sending GAO investigators to the Cayman Islands is not a new government benefit; it “is to get some answers about whether businesses there indeed contribute to the U.S. tax gap.”\textsuperscript{86}

There also is increased interest in the role the Cayman Islands plays in contributing to the tax gap in light of the revelation that Kellogg, Brown and Root (KBR), a Houston-based
company and subsidiary of Haliburton, set up an office in the Caymans to hire employees to serve in Iraq in order to avoid paying U.S. payroll taxes. The House of Representatives Committee on Oversight and Government Reform is investigating government contractors that use foreign subsidiaries to compensate workers under contracts with the United States government, especially in Iraq and Afghanistan, and has requested information about two KBR subsidiaries incorporated in the Cayman Islands. In April 2008, Congress began investigating government contractors that circumvent paying payroll taxes by hiring employees through offshore shell companies. Senators John Kerry and Barack Obama introduced S. 2775, the Fair Share Act of 2008, to prevent companies from avoiding their payroll tax obligations specifically in response to reports of KBR’s desire and attempt to avoid paying U.S. taxes.

In May 2008, several members of the House of Representatives wrote to Treasury Secretary Henry Paulson expressing their concern about federal contractors that hire employees through overseas shell companies to avoid paying U.S. taxes. Congress has suggested that as Secretary Paulson “is charged with closing the tax gap, ‘this would seem an area ripe for [his] review.’” Congress passed, and the President signed, the Heroes Earning Assistance and Relief Tax Act of 2008 (the HEART Act). The HEART Act treats foreign subsidiaries of American companies performing services under a U.S. government contract as American employers for employment tax purposes. Furthermore, under the HEART Act, the domestic parent is jointly liable for employment taxes imposed on the foreign subsidiary.

E. Ensuring Practitioners are Part of the Solution, Not Part of the Problem

The current climate is one of increased scrutiny on transactions designed to reduce taxes and on the role of tax practitioners in “abusive” tax planning. In 2008, return preparer fraud
made IRS’s “Dirty Dozen” list. In the fiscal year 2008 budget, the current administration proposed legislation to expand return preparer penalties.

1. Congressional Concerns About Tax Practitioners

Congress is concerned about the role tax practitioners play in contributing to the tax gap. Congress believes that many tax professionals are part of the problem, affirmatively assisting taxpayer noncompliance and contributing to the tax gap. Congress thinks that in too many cases tax opinion letters no longer contain disinterested and reliable advice, even when issued by supposedly reputable accounting or law firms. Instead, Congress believes that tax opinion letters have become marketing tools. Congress is concerned that law firms became, and still may be, the engines pushing the design and sale of abusive tax shelters.

The 2006 Hearings on Tax Haven Abuse (2006 Hearings), demonstrated that tax professionals--attorneys and non-attorneys--are using secrecy laws of tax havens to conceal abusive tax shelters. The average taxpayer cannot and does not invent complex and sophisticated tax shelters employed by taxpayers to underreport, underpay, and/or evade taxes due and owing and to avoid filing requirements. Indeed “[m]any abusive tax shelters are not dreamed up by the taxpayers who use them. Instead, most are devised by tax professionals, such as . . . lawyers who [sell the tax shelters to clients for a fee.” Additionally, there are “an abundance of tax professionals willing to help companies shirk their tax responsibilities.” During the 2006 Hearings, Congress noted a document prepared by a senior tax professional that stated: “Our average deal would result in KPMG fees of $360,000 with a maximum penalty exposure of only $31,000.” In light of this and other similar egregious revelations during the
2006 Hearings, Congress decided that stronger enforcement was needed to deter such abusive behavior and not merely to penalize it.\(^{107}\)

2. Current and Former IRS Commissioners and IRS Chief Counsel

Current and former Executive Branch tax officials agree with Congressional concerns regarding tax preparers. Former IRS Commissioner Mark Everson stated that: (1) tax professionals can do more to protect the integrity of the system, (2) tax professionals tolerated overly aggressive behavior, and (3) there is a desire on the part of businesses and individuals--aided by the work of attorneys, accountants, and investment bankers--to reduce or eliminate tax altogether and the latter goal (elimination of taxes altogether) is inconsistent with the intention of Congress.\(^{108}\) IRS Chief Counsel Donald Korb has stated: (1) “Private tax attorneys and other practitioners have a responsibility to the IRS, the public, and their own profession--not just their clients--and play a key role in seeing to it that the proper taxes are paid on any given transaction” and (2) tax practitioners are “the first line of defense” against fraud.\(^{109}\) Former IRS Commissioner Larry Gibbs has stated: (1) the widespread problems of highly questionable tax shelters could not have been accomplished without tax attorneys, (2) even if the activities were legal, they still were not good for the public, and (3) it is not about morality, but there needs to be censure and consequences for practitioners.\(^{110}\) Current IRS Commissioner Douglas Shulman stated:\(^{111}\)

> there are a minority of people that use complexity of issues to push the envelope beyond acceptable boundaries.

Let me reiterate something I said a few minutes ago. I view the legal community as an integral part of the overall system of tax administration.
My expectation is that those of you in this room [members of the American Bar Association’s Section of Taxation] who have made your careers in this profession, and care deeply about its reputation -- as I know you do -- will work with us to more quickly understand when the troublesome behavior of a few begins to emerge.

3. IRS Office of Professional Responsibility

IRS Office of Professional Responsibility (OPR) Director Michael Chesman stated: “over [my] 40 years of practice, one of the negative things [I] have seen is a ‘decline in ethical standards’.” Former OPR Director Cono Namorato has stated that most taxpayers who contribute to the tax gap do it with their tax adviser’s knowledge and aid. OPR is increasing its investigations of practitioners for violations of Circular 230. OPR wants its presence felt throughout all segments of the tax practice community--e.g., corporate tax departments, accounting firms, law firms, and even clients.

F. “Tax Defier Initiative”

Government officials are aggressively pursuing people who make frivolous arguments, such as claiming that there’s no law requiring Americans to pay federal income taxes. On April 8, 2008, the U.S. Department of Justice announced the creation of “the National Tax Defier Initiative or TAXDEF.” The purpose of TAXDEF “is to reaffirm and reinvigorate the Tax Division’s commitment to investigate, pursue, and where appropriate, prosecute those who take concrete action to defy and deny the fundamental validity of the tax laws.” The TAXDEF initiative is aimed at stopping taxpayers who seek to transfer their federal tax obligations onto their neighbor’s back.

The TAXDEF initiative also reflects the “intense pressure from Congress” for the IRS to “take more action to reduce” the tax gap. TAXDEF is as much a battle over public perception
as it is about reducing the $345 billion tax gap. This is because “every publicized tax fraud bust increases the deterrent effect.”

G. The Inefficiency of Solely Using (and Funding) Enforcement

Spending money solely on enforcement has a limited effect on reducing the tax gap because, “even if the IRS examined 100 percent of all returns, [it] would identify only a small portion of” the tax gap. Three factors affect the amount of money the government can collect by increased enforcement:

First, much of the gross tax gap for individual income tax filers is due to types of unreported income that are difficult to detect. Second, some of the detected tax liability cannot be easily collected, particularly from those taxpayers who are currently unable to pay. Third, many detected tax liabilities are so small relative to enforcement costs that it is not cost-effective to pursue collection.

Furthermore, GAO analyzed recent IRS funding trends. Over the five-year period FY 2004 through FY 2008, it concluded that funding for enforcement has increased substantially while funding for taxpayer services has been reduced. Based on the Administration’s proposal for FY 2008, it pointed out that funding over the FY 2004 through FY 2008 period would increase by 19.4 percent for enforcement while funding for taxpayer services would decline by 3.8 percent.

The IRS has been criticized for using enforcement processes “that are easy for it, rather than looking at what is best from a compliance perspective.” Additionally, the IRS is focusing on “cheap” enforcement, rather than selecting the “best” cases for enforcement, because the IRS shows a better return on investment in cases where it spends the least amount of money. In May 2007, the Senate Appropriations Committee heard that:

[The fiscal year 2008 budget contains a] fundamental shift in the balance between taxpayer service and enforcement. Under this proposal, the IRS would be spending literally twice as much on enforcement as it spends on taxpayer service. There is no reliable data showing that more enforcement will do more than
taxpayer service to increase compliance. . . the IRS can produce a positive return on investment from more funding in both areas. But given limited resources, . . . it is misguided to ramp up enforcement at the expense of taxpayer service.

Accordingly, in addition to enforcement and more targeted enforcement, in order to reduce the tax gap the government must expend resources on additional methods that decrease noncompliance.

IV. ADDITIONAL METHODS TO REDUCE THE TAX GAP

A. Methodologies for Reducing Intentional Noncompliance

Empirical data suggests that additional tax enforcement alone has a limited effect on reducing the tax gap. Much of the tax gap is related to types of unreported income that are difficult to detect and are not covered by third-party information reporting. For example: “[b]etween fiscal years 2001 and 2006, the IRS increased its enforcement efforts, and the enforcement revenue collected rose from $33.8 billion to $48.7 billion. And while $14.9 billion represents a 44% increase, it [represents] only 4.3% of the . . . tax gap”. Furthermore, although enforcement revenue increased to $59.2 billion in fiscal year 2007, a $10.5 billion increase in enforcement revenue from fiscal year 2006, this increase represents only 3 percent of the $345 billion tax gap. Both the Treasury Department and GAO have stated that a comprehensive strategy, as opposed to focusing solely on enforcement, is needed to reduce the tax gap.

Although enforcement alone cannot significantly reduce the tax gap, the current administration’s fiscal year 2009 budget again predominantly focused on increasing spending on enforcement. The fiscal year 2009 budget froze spending on taxpayer assistance and services and decreased funding for modernization and improving technology. As explained infra, taxpayer assistance and IRS modernization would increase compliance and detect
noncompliance, respectively, and would reduce the tax gap. The Treasury Department, however, predicted that the current administration’s fiscal year 2009 budget would raise only an additional $2 billion in revenue each year by 2011 (less than a fraction of 1 percent of the $345 billion tax gap).

1. Information Reporting

Increased information reporting improves tax compliance. Generally, compliance increases significantly for amounts that a third party reports to the IRS. Only 1.2 percent of wages and salaries were underreported as compared with 57.1 percent of sole proprietor income, primarily because of information reporting and the lack thereof, respectively. The reason compliance rates are “incredibly high” when information is reported by third parties to the IRS is “because taxpayers know that information is going to the IRS.” Accordingly, increased information reporting will reduce noncompliance and the tax gap.

Information reporting allows the IRS determine whether taxpayers’ returns are correct and complete--i.e., whether taxpayers reported (or failed to report) the correct amounts on their returns. “[T]he IRS’s traditional enforcement tools such as document matching and audits are less effective when there is no third party reporting.” Lack of third-party reporting requirements creates and fosters the largest component of the tax gap: underreporting. Underreporting represents 82 percent of the tax gap and underreporting of the correct amount of their income tax owed by sole proprietors represents 57 percent of the tax gap. Accordingly, measures that increase third party reporting (e.g., legislation and regulations) would reduce the tax gap to the greatest extent.
In the fiscal year 2008 and 2009 budgets, the current administration proposed legislation to expand information reporting.\textsuperscript{148} These proposals included: (1) requiring information reporting on payments to corporations; (2) requiring basis reporting on sales of securities; (3) expanding information reporting requirements for brokers; (4) requiring information reporting on merchant payment card reimbursements; and (5) requiring increased information reporting for certain government payments for property and services.\textsuperscript{149} The intent of these proposals is to provide the IRS the information it needs to detect noncompliance.\textsuperscript{150} Proposals to expand information reporting in the current administration’s proposed legislative changes to improve tax compliance accounted for 95.8 percent of the projected additional receipts (i.e., revenue collected by the government) for 2008 through 2012 and 97.9 percent of the additional receipts for 2008 through 2017.\textsuperscript{151}

Although expanding information reporting is a proven method to increase taxpayer compliance, there those who resist and lobby against these proposals.\textsuperscript{152} Some “[o]utside stakeholder groups have expressed concern[s] about the increased burden of additional information reporting requirements,”\textsuperscript{153} and that such “concerns about increased taxpayer [and third parties’] burdens could make it very difficult for legislative proposals [requiring additional information reporting] to become law.”\textsuperscript{154} Opposition stems from the fact that expanding information reporting appears to raise these third parties’ costs (i.e., record keeping and reporting information to the government) without any commensurate benefit to the third party.\textsuperscript{155} Even so, Congress recently passed additional information reporting requirements and the President signed them into law.\textsuperscript{156}
2. Research and Technology

Technology modernization and research also are needed for IRS enforcement personnel to function more effectively.¹⁵⁷ Research is necessary to identify sources of noncompliance so that the IRS can properly target its enforcement efforts and efficiently use its resources.¹⁵⁸ Research allows the IRS to determine what areas (items on a return or types of returns) are the most likely sources of noncompliance. Research (1) is important to identify and combat specific areas of noncompliance; (2) focuses compliance resources on more productive examinations, which results in increased dollar yield per case and fewer no-change audits; and (3) is required on a continuous basis because the tax gap and return selection data become dated.¹⁵⁹ The IRS Oversight Board “identified increased funding for business systems management, security, infrastructure, and research as high priorities [for fiscal year 2009]. These initiatives offer the best opportunity to reduce the tax gap in the long term.”¹⁶⁰ The IRS needs to put more resources into technology and infrastructure.¹⁶¹ Information technology modernization is critical to making the most productive use of taxpayer service and IRS compliance resources.¹⁶² New technology would provide better data and research and would allow IRS examinations to be targeted to situations requiring further analysis while minimizing unnecessary burdens on taxpayers.¹⁶³

Much of the IRS’s technology is outdated and has exceeded its life cycle.¹⁶⁴ Updating technology will maximize enforcement resources and yield greater returns from examinations.¹⁶⁵ New technology, combined with increased information reporting, will improve and allow for more document matching.¹⁶⁶ Additionally, this will improve compliance by having computers select tax returns and taxpayers most likely to be noncompliant.¹⁶⁷ This will allow for early detection and better case selection.¹⁶⁸
3. *Shame*

Another option to deter noncompliance is shaming. Over 20 states have collected hundreds of millions of dollars in unpaid tax liabilities from delinquent taxpayers whose names and addresses were published on state government web sites (as taxpayers have sought to remove their names from the lists). Referencing the Eliot Spitzer scandal as an example, it has been suggested that shaming tax cheats could reduce noncompliance:

If shaming can curb the human desire that underwrites the oldest profession, it can surely curb tax evasion. In fact, researchers have shown that tax penalties relying on social punishment rather than economic or legal sanction can be effective in improving tax compliance. Shaming deters tax evasion by expressing society’s condemnation of cheating, and by displaying the cheater’s bad acts for all to see. People undoubtedly comply with laws for various reasons, but fear of detection provides the strongest compliance incentive.

Shaming, in addition to its deterrent effect, also provides the additional benefit of generating revenue. Shaming at the federal level could reduce the tax gap:

Enforcement through shaming could attack all forms of tax abuse. These include high-income and corporate taxpayers who take artificial losses to offset taxable gains, as well as smaller-scale abuses such as the widespread practice of individuals illegally claiming home office deductions.

Wide publication is the key. Publishing the names and underpayments of tax cheats on the Internet and media outlets would subject the cheats to the court of public opinion. Similarly, wide exposure should be used to discourage tax advisers from writing questionable legal opinions supporting sophisticated tax avoidance strategies.

Indeed, the federal government’s tax shaming strategy should publish for public scrutiny a list of delinquent taxpayers as well as wayward tax advisers.

The government has been publicizing indictments of, convictions of, and injunctions against taxpayers who do not comply with the law and those who aid and abet taxpayers in such noncompliance. There is a limit, however, to how much shaming the federal government can
do. The Code provides, as a general rule, that returns and return information, including the names of taxpayers and the amounts owed, are confidential.\textsuperscript{174} Except as authorized by the Code, no officer or employee of the United States can disclose any return or return information.\textsuperscript{175}

Additionally, the Code provides for civil damages for unauthorized inspection or disclosure of returns and return information.\textsuperscript{176} Unauthorized disclosures can result in civil liability,\textsuperscript{177} criminal prosecution,\textsuperscript{178} and termination of employment.\textsuperscript{179} Accordingly, Congressional action is required for shaming at the federal level.\textsuperscript{180}

An alternative to government shaming (active shaming) is requiring taxpayers to shame themselves (dormant shaming). A new government-wide rule will require companies seeking federal contracts to certify whether they have any outstanding tax indebtedness in excess of $3,000.\textsuperscript{181} This rule was proposed in 2007 in response to GAO reports of contractors failing to pay their taxes.\textsuperscript{182} To identify noncompliance with the law the “government should be asking potential contractors . . . whether they have any outstanding tax indebtedness . . . or whether they have any outstanding unresolved federal or state tax lien.”\textsuperscript{183} The government has stated that this “rule is ‘not intended as a tool to collect taxes’ for the Internal Revenue Service”.\textsuperscript{184} Regardless, the rule should reduce the tax gap as disclosures are likely to pressure the IRS to collect, or contractors to pay, the disclosed unpaid tax liabilities.\textsuperscript{185}

\textit{4. International Coordination and Cooperation}

The IRS is investing more money to detect offshore tax evasion.\textsuperscript{186} The IRS is focusing its resources on “getting highly specific information about taxpayers’ international financial activities.”\textsuperscript{187} The IRS has started consulting with tax revenue agencies of foreign governments to address new frontiers noncompliance.\textsuperscript{188}
B. Methodologies for Reducing Unintentional Noncompliance

Enforcement does not help taxpayers who want to comply with the law but do not understand it or reasonably disagree with the government’s interpretation of the law. The government can resolve unsettled or unclear areas of the law--thereby helping taxpayers avoid unintentional noncompliance. This IRS should assist taxpayers, who want to be compliant, and help them avoid unintentional errors. This way the IRS would be able to focus its enforcement resources on taxpayers who intentionally are noncompliant and intentionally create the tax gap.

1. Simplification

Simplifying the Code will reduce the tax gap. The tax gap is, in part, a result of the complexity of the Code. “The IRS estimates that approximately $32 billion [i.e., approximately 10 percent] of the tax gap is due to errors in claiming tax credits and deductions.” In 2006, paid preparers at several commercial tax-preparation chains made major errors preparing returns when undercover GAO investigators tested them. By making it easier for taxpayers to comprehend the law, taxpayers can avoid unintended noncompliance by understanding how much they owe and if and when they are required to file returns. Simplifying the Code would do more to reduce the tax gap than increasing the IRS’s enforcement power. Even Congress recognizes that “the complications created by our tax system outweigh its benefits.”

2. Published Guidance

Published guidance can reduce tax avoidance, increase taxpayer compliance, and clarify ambiguous areas of the law. Providing taxpayers with clear published guidance before they file their tax returns could potentially reduce the tax gap by up to $32 billion. The IRS intends
to build on its previous attempts to provide published guidance.\textsuperscript{201} “It is best for the Service to front-load guidance . . . and get it out as quickly as possible. ‘If you tell people what the rules are, most people are going to follow the rules’.”\textsuperscript{202}

The government “should not be contributing to potential noncompliance by issuing rules and regulations subject to multiple and varied interpretations.”\textsuperscript{203} For example, in April 2008, the IRS launched a campaign to educate new self-employed small business owners about their federal tax responsibilities.\textsuperscript{204}

Additionally, OPR is preparing to publish details of its disciplinary proceedings.\textsuperscript{205} OPR’s plan is to publish a series of hypothetical cases, to illustrate not only what practitioners should not do but also to highlight best practices.\textsuperscript{206} “OPR’s goal is to prevent bad things from happening, not just punish offenders after the fact.”\textsuperscript{207}

V. CONCLUSION

How to best allocate IRS resources in order to reduce the tax gap is at least partially subjective.\textsuperscript{208} The current administration, Executive Branch officials, the IRS, and Congress have invested in auditing and collecting from high-income taxpayers and corporations.\textsuperscript{209} Recent administration budgets have increased spending for enforcement while freezing spending on taxpayer services and decreasing funding for research and technology.\textsuperscript{210} This, however, has been ineffective at reducing the tax gap because although

there is little debate on the need for increased IRS enforcement resources, this is not a quick path to eliminating the tax gap. Because the largest portion of the tax gap is not yet assessed, the IRS must identify the noncompliant taxpayer, examine the return, and then assess the tax. After these processes, the IRS attempts to collect the tax due. The ability to efficiently and effectively complete this enforcement cycle is affected by a combination of laws and regulations, internal polices and procedures, technology, and human capital management.
Realizing additional collected revenue by adding additional examination resources shows a modest initial return on investment.211 The “IRS cannot ‘audit its way out of the tax gap,’ and should avoid the temptation to reduce the tax gap with large staffing increases in revenue-producing functions that cannot be absorbed effectively.”212 The IRS cannot focus solely on either service or enforcement. “[T]he IRS must do both, and do both very well.”213 Indeed “no single approach will be successful at substantially reducing noncompliance.”214 Accordingly, a synergized, multi-pronged approach--rather than solely spending money on enforcement--is necessary to reduce noncompliance and the tax gap.

Information reporting is a proven method, and likely the best method, to improve voluntary tax compliance and reduce the tax gap.215 Compliance is less than 50 percent when there is no information reporting. The majority of the tax gap is created by noncompliance by sole proprietorships whose income (gross receipts) is not subject to information reporting requirements. Accordingly, lobbyists and special interest groups opposed to additional information reporting will have to take a back seat if Congress’ desire to reduce the tax gap is sincere.

Technology modernization and research also are needed to allow IRS enforcement personnel function more effectively.216 Research allows the IRS to determine what areas (items on a return or types of returns) are the most likely sources of intentional noncompliance. Spending money solely on enforcement has a limited effect on reducing the tax gap. Updating technology, to allow for greater document matching (combined with increased information reporting) and having computers select tax returns most likely to be noncompliant will maximize enforcement resources and yield greater returns from examinations. This synergy of research,
information reporting, and technology will allow the IRS to reduce the tax gap by targeting its enforcement efforts and its resources to examining taxpayers who contribute to the tax gap and decreasing the number of “no change” audits.

Vigorous disciplinary action by OPR will discourage abusive, egregious, and questionable tax planning by tax practitioners. Publicity of OPR disciplinary actions will cleanse the profession of those willing to aid taxpayer noncompliance. Obtaining injunctions against tax practitioners who abuse the Code will also decrease noncompliance. Thus, OPR and the U.S. Department of Justice Tax Division will play a key role in reducing the tax gap by eliminating those practitioners who actively, aggressively, and intentionally contribute to it.

In a global economy, a commitment to extensive international cooperation also will be necessary. Given the amount of the tax gap attributable to offshore tax evasion ($50 to $100 billion), the U.S. government will need to work with other nations and foreign banks to close down tax haven jurisdictions and improve transparency in global financial markets.

Additionally, simplification and publication of clear guidance should reduce the incidence of unintended noncompliance. Furthermore, once those who want to comply can and those who do not comply are caught by enforcement programs, the IRS still will need to collect the amounts due. Tax officials need to rethink how the collection queue operates. Going after the most collectable accounts first instead of the highest dollar accounts should reduce the number of accounts in the queue and increase the amount of revenue collected. Collection more of the taxes due and owing that are in the queue will reduce the tax gap.

Enforcement alone is not enough to reduce the tax gap. In order to significantly reduce the tax gap the government must simultaneously (1) leverage enforcement to target intentional
noncompliance through additional information reporting, research, technology, disciplinary actions, publicity, and international cooperation; (2) help taxpayers avoid unintentional noncompliance via simplification and published guidance; and (3) maximize collection by working the most collectable cases first, rather than the highest dollar cases.

ENDNOTES

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2 Id.

3 For convenience, I refer to all people, as defined by I.R.C. § 7701(a)(1) (“The term ‘person’ shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.”), as “taxpayers” even though it may be malapropos as some of these people are not reporting and/or paying the correct amount of taxes they owe and/or that are due.

4 CRS Updates Report on Tax Gap, Enforcement, 2008 TNT 38-15 (Jan. 28, 2008) (“Other motivations for reducing the tax gap include adverse effects on (1) public trust in the fairness of the tax system, which may adversely affect voluntary compliance with the tax laws”) (CRS Update). “The public’s confidence in our tax system rests, in significant part, on their perception of fairness in the administration of the tax laws.” B. John Williams, Remarks at the Meeting of the New York State Bar Association Tax Section (Jan. 21, 2003) (remarks of Internal Revenue Service (IRS) Chief Counsel, reprinted in Hartman v. Commissioner, T.C. Memo. 2008-124, Appendix A). “[A] large part of our job is to encourage people to be law-abiding citizens. And that means getting the word out about repercussions . . . . Furthermore, those citizens who abide by the law should know about and take comfort in the fact that those who do not pay what they owe will be held accountable.” Jeremiah Coder, Conversations: Nathan Hochman, 118 TAX NOTES 799 (Feb. 18, 2008) (statement of Assistant Attorney General for Tax, U.S. Department of Justice). “[N]ot only does tax compliance, or rather, tax non-compliance, violate fundamental notions of fairness, it also has real and significant economic consequences to this nation”—i.e., the tax gap. Transcript of Nathan J. Hochman, Tax Division’s Assistant Attorney General Announcing the Creation of the National Tax Defier Initiative, 2008 TNT 70-57 (Apr. 9, 2008). “Taxpayers who do not voluntarily pay their share of taxes create unfair burden on honest taxpayers and diminish the public’s respect for the tax system.” Treasury Inspector General For Tax Administration, Additional Actions Are Needed to Effectively Address the Tax Gap, (Reference Number: 2008-30-094), Apr. 23 2008, Memorandum at 1, available at http://www.ustreas.gov/tigta/auditreports/2008reports/200830094fr.pdf (TIGTA Additional Actions Report); 2008 TNT 86-33 (May 2, 2008). The Department of Justice, Tax Division, is moving forward with civil injunctions to stop noncompliance, rather than waiting to criminally prosecute individuals who promote noncompliance, in order to
"honest taxpayers know that they are not ‘snooks’ for having paid their fair share of taxes." — BNA, DAILY TAX REPORT, Mar. 14, 2008, p. K-1.

Although some would like to deny that the tax system plays a vital role in society, and few of us actually like paying taxes, confidence in the integrity and fairness of the tax system is vital to our democracy. The tax system touches more people in this country than any other part of the government or our laws. The loss of confidence in its integrity is the loss of confidence in the government itself.


5 See supra note 4.


7 CRS Update, supra note 4. Note that the tax gap for 2001 does not include amounts from the (1) non-filing of corporate income tax, employment tax, or excise tax returns and (2) underreporting of excise taxes as no estimates were available for these items. Id., Appendix, Figure 1 (listing the source of this information as the U.S. Treasury, Internal Revenue Service, February 2007).

8 Government Economists Identify Possible Sources of Underreporting, 119 TAX NOTES 657 (May 19, 2008); CRS Update, supra note 4; 2007 TNT 93-8 (May 14, 2007).

In 2006, approximately one in seven federal income tax returns included a Schedule C, Profit or Loss from Business, or a Schedule C-EZ, Net Profit for Business, totaling over 21 million Schedules C which reported overall net profits from sole proprietorships totaling more than $269 billion. I.R.S. News Release, IR-2008-63 (Apr. 22, 2008). Approximately 18 million sole proprietorships account for $68 billion of the $197 billion tax gap related to individual income underreporting. Government Economists Identify Possible Sources of Underreporting, 119 TAX NOTES 657 (May 19, 2008). Although sole proprietorships account for less than 5 percent of all gross receipts their underreporting of income accounts for approximately 20 percent of the overall tax gap. Id.; IRS Releases Tax Gap Fact Sheet on Reporting Business Income, 2008 TNT 93-20 (May 12, 2008) (“Internal Revenue Service research indicates that understated business income contributes significantly to the tax gap, with the majority understated by small businesses.”); I.R.S. Fact Sheet, FS-2008-20 (Apr. 2008); High Earners Face Surge in Tax Audits, WALL STREET JOURNAL, Jan. 30, 2008 (“IRS research indicates much of the tax-noncompliance is committed by self-employed workers ... whose taxes aren’t withheld from their pay and whose income isn’t reported separately to the government.”); CRS Update, supra note 4; 2007 TNT 93-8 (May 14, 2007); Transcript of Nathan J. Hochman, Tax Division’s Assistant Attorney General Announcing the Creation of the National Tax Defender Initiative, 2008 TNT 70-57 (Apr. 9, 2008) (“a significant portion of [the tax gap] is attributable to individual and small businesses engaged in non-compliance.”). “Self-employment tax is estimated to make up about $39 billion (72 percent) of underreported
employment taxes, or 11 percent of the total gross tax gap, making it one of the largest components of the tax gap.”


For example, “a panel of tax experts” testifying at a Senate Finance Committee hearing stated that Congress should consider closing “loopholes” that “contribute to the ‘tax gap’ of legally owed but unpaid taxes.” 2008 TNT 94-33 (May 13, 2008). “Loophole” is a pejorative term for an unintended consequence of a law. Additionally, perspective matters on whether something is a loophole (one person’s “loophole” is another person’s “benefit”). Regardless of whether a legal tax strategy is an intended or unintended benefit, it is not noncompliance. Intended or unintended it is the law. A “loophole” is not cheating, attempting to evade taxes due and owing, failing to file a return, underreporting of income, or an underpaying taxes due and owing.

See supra note 9.

See supra note 8 and accompanying text, and note 9.


Transcript of Nathan J. Hochman, Tax Division’s Assistant Attorney General Announcing the Creation of the National Tax Defier Initiative, 2008 TNT 70-57 (Apr. 9, 2008).

TIGTA Additional Actions Report, supra note 4, at 1.

CRS Update, supra note 4. “This IRS faces congressional pressure to” reduce the tax gap from “lawmakers in both parties.” Tom Herman, Tax Report, IRS Is Likely to Get More Resources To Combat Cheating on Tax Returns, WALL STREET JOURNAL, Feb. 6, 2008; see also Tom Herman, Tax Report, How a Tax Adviser Can Get You in Trouble, WALL STREET JOURNAL, Mar. 26, 2008 (“The [IRS] continues to face intense pressure from Congress to cut the ‘tax gap’”). “With the U.S. national deficit rising, [the] IRS is under growing pressure to shrink the tax gap and bring in dollars.” BNA, DAILY TAX REPORT, May 6, 2008, p. G-1.

Even so, during 2008 the IRS has had to shift workers away from enforcement operations to answer millions of taxpayer phone calls regarding the 2008 economic-stimulus payment. Tom Herman, Answers to Rebate-Payment Questions, WALL STREET JOURNAL, Apr. 30, 2008, at D4. The U.S. Government Accountability Office (GAO) estimates that moving enforcement personnel from their regular work to answering phone calls has cost the government up to $565 million in forgone enforcement revenue. Id.


TIGTA *Additional Actions Report*, supra note 4, at 1; *CRS Update*, supra note 4.

TIGTA *Additional Actions Report*, supra note 4, at 1; *CRS Update*, supra note 4.

TIGTA *Additional Actions Report*, supra note 4, at 1; *CRS Update*, supra note 4.

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TIGTA *Additional Actions Report*, supra note 4, at 1; *CRS Update*, supra note 4.

TIGTA *Additional Actions Report*, supra note 4, at 1; *CRS Update*, supra note 4.

TIGTA *Additional Actions Report*, supra note 4, at 1; *CRS Update*, supra note 4.


26 TIGTA *Additional Actions Report*, supra note 4, at 1; *CRS Update*, supra note 4 (Statement of Senator Baucus). “Under the U.S. tax system, most taxpayers file a timely return with the IRS and report their tax liability to the best of their ability. Unfortunately, for many taxpayers, April 15 is not a day for telling the ‘whole’ truth about their taxes, but instead is a day for telling as much of the truth as the IRS will uncover.” Joann M. Weiner, *Truth and Taxes*, 119 Tax Notes 249, 250 (Apr. 21, 2008).


28 CRS Update, supra note 4.

29 2007 TNT 72-23 (Apr. 12, 2007).

30 Joann M. Weiner, *Truth and Taxes*, 119 Tax Notes 249, 250 (Apr. 21, 2008); *Written Statement of Nina E. Olsen National Taxpayer Advocate before the Subcommittee on Financial Services and General Government Committee on Appropriations United States Senate Hearing on Internal Revenue Service FY 2009 Budget Request*, 2008 TNT 75-50 (Apr. 16, 2008) (“households that comply with their tax obligations effectively pay a “surtax” averaging about $2,680 per year to subsidize noncompliance by others”) (citation omitted); *Testimony of IRS Oversight Board Chairman Paul Cherecwich, Jr., before the Senate Committee on Appropriations Subcommittee on Financial Services and General Government Committee*, 2008 TNT 75-52 (Apr. 16, 2008). Stated another way, “‘If everyone paid the taxes they owed, average individual income taxes paid per taxpayer could have been 32.1 percent less.’” Joann M. Weiner, *Truth and Taxes*, 119 Tax Notes 249, 250 (Apr. 21, 2008) (quoting “the FairTax organization”).

source of the tax gap is clear. Well over half of the nearly $200 billion in underreported individual income tax liability arises when no one but the taxpayer verifies the amounts reported on the return.”).

32 TIGTA Additional Actions Report, supra note 4, at 4; Tom Herman, Tax Report, IRS Is Likely to Get More Resources To Combat Cheating on Tax Returns, WALL STREET JOURNAL, Feb. 6, 2008 (“All of the IRS studies of compliance suggest that improved reporting leads to improved compliance.”) (statement of Clint Stretch, managing principal for tax policy at Deloitte Tax LLP in Washington, D.C.); BNA, DAILY TAX REPORT, Jan. 24, 2007, p. G-10; High Earners Face Surge in Tax Audits, WALL STREET JOURNAL, Jan. 30, 2008 (“IRS research indicates much of the tax-noncompliance is committed by self-employed workers . . . whose taxes aren’t withheld from their pay and whose income isn’t reported separately to the government.”); see also Written Testimony of Commissioner of Internal Revenue, Mark Everson, Before the Senate Committee on the Budget on the FY 2008 IRS Budget and the Tax Gap, Feb. 14, 2007, BNA, DAILY TAX REPORT, Feb. 15, 2007, TaxCore, p. 11. “‘[G]enerally, compliance increases significantly for amounts that a third party reports to the [IRS].’” BNA, DAILY TAX REPORT, Apr. 2, 2008, p. G-1 (quoting the Treasury Department’s General Explanations of the Administration’s Fiscal Year 2009 Revenue Proposals (a.k.a. The Blue Book)); see Joann M. Weiner, Truth and Taxes, 119 TAX NOTES 249, 250 (Apr. 21, 2008); Written Statement of Nina E. Olsen National Taxpayer Advocate before the Subcommittee on Financial Services and General Government Committee on Appropriations United States Senate Hearing on Internal Revenue Service FY 2009 Budget Request, 2008 TNT 75-50 (Apr. 16, 2008) (the cash economy “is probably the single largest component of the tax gap, likely accounting for over $100 billion per year.”) (citation omitted).

The reason compliance rates are “incredibly high” when information is reported by third parties to the IRS is not only “because taxpayers know that information is going to the IRS” but also because “individuals and the IRS are accustomed to working from the same set of information, in the same format.” Remarks of IRS Commissioner Douglas Shulman before the American Bar Association, BNA, DAILY TAX REPORT, May 13, 2008, TaxCore; 2008 TNT 92-69 (May 9, 2008). Additionally, when information is available in a standard, easily accessible format taxpayers and the IRS can work more effectively and the level of honest dialog increases. See Remarks of IRS Commissioner Douglas Shulman before the American Bar Association, BNA, DAILY TAX REPORT, May 13, 2008, TaxCore; 2008 TNT 92-69 (May 9, 2008).

33 Underreporting of sole proprietor income tax represents 57 percent of the overall tax gap. Government Economists Identify Possible Sources of Underreporting, 119 TAX NOTES 657 (May 19, 2008); CRS Update, supra note 4; 2007 TNT 93-8 (May 14, 2007). See also Joann M. Weiner, Truth and Taxes, 119 TAX NOTES 249, 250 (Apr. 21, 2008); Written Statement of Nina E. Olsen National Taxpayer Advocate before the Subcommittee on Financial Services and General Government Committee on Appropriations United States Senate Hearing on Internal Revenue Service FY 2009 Budget Request, 2008 TNT 75-50 (Apr. 16, 2008) (the cash economy “is probably the single largest component of the tax gap, likely accounting for over $100 billion per year.”) (citation omitted).

34 Congress Set to Eliminate Loophole on Some Long-Term Capital Gains, WALL STREET JOURNAL, Feb. 14, 2007; Tax Administration Goes Global, E&Y, 114 TAX NOTES 847, 847 (Feb. 26, 2007). The Times Are They A’Changin’?, 114 TAX NOTES, 475, 475 (Jan. 29, 2007);

35 2008 TNT 83-23 (Apr. 28, 2008).


37 CRS Update, supra note 4.
Tom Herman, Tax Report, IRS Is Likely to Get More Resources To Combat Cheating on Tax Returns, WALL STREET JOURNAL, Feb. 6, 2008 (“Squeezing money out of those who owe taxes is seen as a smarter move politically than raising taxes, especially in an election year.”); BNA, DAILY TAX REPORT, Oct. 27, 2006, p. G-1.

House Budget Committee Chair, John M. Spratt, Jr., stated “[The tax gap] is a way to raise revenues without raising taxes.” 2008 TNT 45-2 (Mar. 6, 2008). The palatability of raising revenue via enforcement has drastically changed over the last decade. See, e.g., Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, 112 Stat. 685 (1998) and the accompanying legislative history.

BNA, DAILY TAX REPORT, Mar. 8, 2007, p. G-7 (speakers at IRS Oversight Board roundtable).


Written Testimony of Commissioner of Internal Revenue, Mark Everson, Before the Senate Committee on the Budget on the FY 2008 IRS Budget and the Tax Gap, Feb. 14, 2007, BNA, DAILY TAX REPORT, Feb. 15, 2007, TaxCore, p. 3; Tom Herman, Tax Report, IRS Is Likely to Get More Resources To Combat Cheating on Tax Returns, WALL STREET JOURNAL, Feb. 6, 2008; High Earners Face Surge in Tax Audits, WALL STREET JOURNAL, Jan. 30, 2008 (noting “an 84% surge in audits of those with incomes of $1 million or more.”).


Id. Corporate audits, however, may decrease in the future as Frank Ng, LMSB (Large and Mid-Size Business Division) Commissioner stated that the “success of the compliance assurance program (CAP)” could make it a victim of its own success as “‘CAP results don’t yield any enforcement dollars.’” 2008 TNT 100-5 (May 22, 2008). LMSB audits average 14 months for completion, large companies average 24 months, the very largest companies take approximately 36 months; however, the CAP process takes approximately 6 months. Id.


BNA, DAILY TAX REPORT, May 16, 2008, p. G-4 (statement of John Tuzynski, chief of Employment Tax Operations in the Small Business/Self-Employed Division). “A review of statistics showed significant income possibilities for the government from addressing the classification issue.” Id. There is no “bright line” between independent contractors and employees; however, “At present, IRS is precluded from providing any formal guidance on the issue” thus leaving enforcement as the only method for resolving this issue. Id. But see infra Part IV.B.2.
By going after the highest dollar cases, it is likely that low and middle income taxpayers, who are more likely to have smaller dollar amounts to collect, are disproportionately impacted by this strategy. Low and middle income taxpayers gradually become less able to pay their outstanding tax debt by the time the government seeks to collect it. This debt might have been manageable if the collection process started soon after assessment of the taxes. An analysis of this issue (horizontal equity) and whether low and middle income taxpayers are disproportionately impacted by the IRS’s collection methodology, however, is beyond the scope of this article.

Although the net collection of a mere $11 million by private collection agencies might have created some fear of being sought out by private debt collectors, and might have lead to some amount of additional compliance that is not easily quantifiable, this issue is beyond the scope of this article.


See supra note 13.

BNA, DAILY TAX REPORT, Feb. 27, 2008, p. GG-1 (statement of Dave Hartnett, Acting Chairman, Her Majesty’s Revenue & Customs, United Kingdom).


Jeremiah Coder, Conversations: Nathan Hochman, 118 TAX NOTES 799 (Feb. 18, 2008).

Lee A. Sheppard, News Analysis: Offshore Investments: Don’t Ask, Don’t Tell, 2005 TNT 132-4 (July 12, 2005).

IRS, Levin Join Fray Over Liechtenstein Tax Evasion, 118 TAX NOTES 987 (Mar. 3, 2008) (also stating “It should be clear from recent events that there is no safe hiding place for the proceeds of tax avoidance and evasion.”); see also Tom Herman, Tax Report, Offshore-Account Holders Bite Their Nails, WALL STREET JOURNAL, May 21, 2008 (“‘Combating offshore tax avoidance and evasion are high priorities for the IRS.’ says IRS Commissioner Doug Shulman.”).


“International Planning & Operations Council”: part of LMSB [Large and Mid-Size Business Division] with representatives from counsel, appeals, criminal investigation, & SB/SE [Small Business/Self-Employed Division]. BNA, DAILY TAX REPORT, Jan. 16, 2007, p. S-25 (Frank Ng, IRS Deputy Commissioner (International); The Times Are They A’Changin’?, 114 TAX NOTES, 475, 475 (Jan. 29, 2007); Tax Administration Goes Global, E&Y, 114 TAX NOTES 847, 847 (Feb. 26, 2007); 2008 TNT 43-8 (statements by Dean Zerbe, former Senior Counsel and Tax
In May 2008, two foreign bankers were indicted for allegedly facilitating attempted tax evasion on $200 million by Igor Olenicoff. Former UBS Banker Indicted in Tax Evasion Case, 119 Tax Notes 653 (May 19, 2008); Indictment in United States v. Birkenfeld, BNA, Daily Tax Report, May 14, 2008, TaxCore. Mr. Olenicoff has been cooperating with Unites States authorities since pleading guilty to filing a false tax return for 2002 and paying $52 million in back taxes.

The two foreign bankers marketed Swiss banking services to wealthy U.S. clients to implement tax evasion schemes. Indictment in United States v. Birkenfeld, BNA, Daily Tax Report, May 14, 2008, TaxCore. The tax evasion scheme used Liechtenstein and Swiss banks and Danish shell companies. Former UBS Banker Indicted in Tax Evasion Case, 119 Tax Notes 653 (May 19, 2008). The foreign bankers allegedly advised Mr. Olenicoff to move...
all his assets to Liechtenstein because of its superior secrecy laws and he was told that Swiss and Liechtenstein bank secrecy laws were impenetrable. *Id.*; *Indictment in United States v. Birkenfeld*, BNA, *DAILY TAX REPORT*, May 14, 2008, TaxCore. This was the cornerstone of the tax evasion scheme. *Indictment in United States v. Birkenfeld*, BNA, *DAILY TAX REPORT*, May 14, 2008, TaxCore; 2008 TNT 94-38 (May 13, 2008). Notably, in an email to Mr. Olenicoff, one of the foreign bankers allegedly advised Mr. Olenicoff that “there was no need for an address, fax, and telephone number for the Danish holding companies because, ‘...we do not anticipate any contact from third parties what so ever.’” *Indictment in United States v. Birkenfeld*, BNA, *DAILY TAX REPORT*, May 14, 2008, TaxCore (emphasis added). Without Mr. Olenicoff’s cooperation, however, one wonders what information the government would have learned.


87 2008 TNT 96-30 (May 15, 2008) (noting that Senator Byron Dorgan was taking steps to putting an end to the practice of defense contractors running the payroll of U.S. employees through tax havens to avoid paying U.S. Taxes); BNA, *DAILY TAX REPORT*, May 14, 2008, p. G-8; 2008 TNT 94-34 (May 7, 2008) (concern raised by Senator Dorgan); BNA, *DAILY TAX REPORT*, Apr. 17, 2008, p. G-7 (concern raised by Senator Richard Durbin); 2008 TNT 64-28 (Apr. 1, 2008) (from hearing statement of Senator Baucus). KBR’s representatives have stated that the primary purpose of setting up offices and incorporating subsidiaries in the Cayman Islands was to reduce KBR’s tax obligations. 2008 TNT 82-97 (Apr. 22, 2008) (letter from Congressman Henry A. Waxman); see also 2008 TNT 94-34 (May 7, 2008) (“KBR’s own spokesperson, Heather Brown, acknowledged in writing that the two Cayman Islands companies were set up ‘in order to allow us to reduce certain tax obligations of the company and its employees.’”); BNA, *DAILY TAX REPORT*, Apr. 25, 2008, p. G-2.

88 2008 TNT 82-96 (Apr. 24, 2008).

89 Congressmen Rahm Emanuel and Brad Ellsworth introduced a companion bill (H.R. 5602), and Representative Emanuel added similar language to the Taxpayer Assistance and Simplification Act of 2008 (H.R. 5719). BNA, *DAILY TAX REPORT*, Apr. 25, 2008, p. G-2. Senator Dorgan offered an amendment to the fiscal year 2008 Emergency Supplemental “that would restrict any of the supplemental funds from going to a firm that sets up offshore subsidiaries for the purpose of avoiding U.S. payroll taxes.” 2008 TNT 94-34 (May 7, 2008). The Senate passed the supplemental war funding bill, including Senator Dorgan’s amendment (which is part of the Senate’s substitute amendment to the House-passed war supplemental bill (H.R. 2642). 2008 TNT 101-4 (May 23, 2008). This supplemental war funding bill was passed by Congress and signed by the President as the Supplemental Appropriations Act, 2008, Pub. L. No. 110-252, 122 Stat. ____ (2008).


95 CRS Update, supra note 4.


98 Id.

99 Id.

100 Id. See also supra Part III.D and note 81.


102 Id.


105 Id.

106 Id.

107 Everson to Tax Bar: You Should Do More, 2007 TNT 14-3 (Jan. 22, 2007). This point of view is diametrically opposed to one of the most basic lessons taught in the beginning of introductory (basic) income tax classes. As explained by Judge Learned Hand almost 75 years ago: “Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.” Helvering v. Gregory, 69 F.2d 809, 810-811 (2d Cir. 1934), aff’d 293 U.S. 465 (1935).

115 Tax Notes 495 (Apr. 30, 2007).


121 Justice Launches National Tax Fraud Crackdown, 119 Tax Notes 141 (Apr. 14, 2008).


123 TIGTA Additional Actions Report, supra note 4, at 13-15, 16.

124 CRS Update, supra note 4.

125 Written Statement of Nina E. Olsen National Taxpayer Advocate before the Subcommittee on Financial Services and General Government Committee on Appropriations United States Senate Hearing on Internal Revenue Service FY 2009 Budget Request, 2008 TNT 75-50 (Apr. 16, 2008) (citation omitted) (further noting that the current administration’s proposed budget for fiscal year 2009 would continue this trend); see also Statement of The Honorable J. Russell George Treasury Inspector General For Tax Administration before the Subcommittee on Financial Services and General Government Committee on Appropriations U.S. Senate, 2008 TNT 75-51 (Apr. 16, 2008) (“the IRS seeks to increase funding for Enforcement, Operations Support, and the Health Insurance Tax Credit...”)
Administration while decreasing funding for Business System Modernization” and “The funding for Taxpayer Services remains the same as the Fiscal Year 2008 enacted level.”).


127  Id.

128  CRS Update, supra note 4 (citing Nina E. Olsen, National Taxpayer Advocate, Written Statement before the Subcommittee on Financial Service and General Government, Senate Appropriations Committee, May 9, 2007, p. 4); see also Testimony of IRS Oversight Board Chairman Paul Cherecwich, Jr., before the Senate Committee on Appropriations Subcommittee on Financial Services and General Government Committee, 2008 TNT 75-52 (Apr. 16, 2008).

129  CRS Update, supra note 4.

130  See, e.g., supra notes 7 and 30 and the accompanying text.

131  See CRS Update, supra note 4 (“Unintentional taxpayer errors and intentional taxpayer evasion should both be addressed. . . . Enforcement activities should be combined with a commitment to taxpayer service”).

132  2008 TNT 83-3 (Apr. 29, 2008); Written Testimony of Douglas Shulman Commissioner of Internal Revenue before the Senate Appropriations Committee Subcommittee on Financial Services and General Government on FY 2009 IRS Budget, 2008 TNT 75-49 (Apr. 16, 2008) (noting that the increased enforcement revenue does not include the deterrent effect that increased enforcement has on voluntary compliance); Written Statement of Nina E. Olsen National Taxpayer Advocate before the Subcommittee on Financial Services and General Government Committee on Appropriations United States Senate Hearing on Internal Revenue Service FY 2009 Budget Request, 2008 TNT 75-50 (Apr. 16, 2008) (stating “Economists have estimated that the indirect effects of an examination on voluntary compliance provide further revenue gains. While the indirect revenue cannot be precisely quantified, two of the more prominent studies in the area suggest the indirect revenue gains are between six and 12 times the amount of the proposed adjustment.”); Testimony of IRS Oversight Board Chairman Paul Cherecwich, Jr., before the Senate Committee on Appropriations Subcommittee on Financial Services and General Government Committee, 2008 TNT 75-52 (Apr. 16, 2008); IRS: Fiscal 2007 Enforcement Led to $10 Billion Revenue Gain, 118 TAX NOTES 372 (Jan. 21, 2008). But see supra note 12 (survey results showed that in 2007 more taxpayers felt that cheating on taxes was acceptable than in 2005).


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Written Testimony of Douglas Shulman Commissioner of Internal Revenue before the Senate Appropriations Committee Subcommittee on Financial Services and General Government on FY 2009 IRS Budget, 2008 TNT 75-49 (Apr. 16, 2008); CRS Update, supra note 4.

Written Testimony of Douglas Shulman Commissioner of Internal Revenue before the Senate Appropriations Committee Subcommittee on Financial Services and General Government on FY 2009 IRS Budget, 2008 TNT 75-49 (Apr. 16, 2008); Tom Herman, Tax Report, IRS Is Likely to Get More Resources To Combat Cheating on Tax Returns, WALL STREET JOURNAL, Feb. 6, 2008; CRS Update, supra note 4. “Cost-basis reporting is ‘a common-sense tax-gap measure whose time has come.’” Id. (quoting Senator Grassley).  See also Tom Herman, Tax Report, *What Congress Is Likely to Do to Your Tax Bill*, WALL STREET JOURNAL, May 14, 2008 (stating that “cost basis” reporting “would raise additional revenue, and could be sold as improved tax-law compliance, not a tax increase.”); Remarks of IRS Commissioner Douglas Shulman before the American Bar Association, BNA, DAILY TAX REPORT, May 13, 2008, TaxCore (“I am inclined to support information reporting regimes that allow the taxpayer and the tax administrator to start the process with transparent and consistent information. With this information, the IRS can focus its time and resources”); 2008 TNT 92-69 (May 9, 2008).


TIGTA Additional Actions Report, supra note 4, Memorandum at 2; CRS Update, supra note 4.

TIGTA Additional Actions Report, supra note 4, Memorandum at 2.


TIGTA Additional Actions Report, supra note 4, at 13.

Additional information reporting will reduce the tax gap. Accordingly, an indirect benefit to these third party record keepers may be lower tax rates. As the government collects more revenue by decreasing noncompliance via additional information reporting provided by third parties the government would be able to decrease the tax burden on such third parties while still increasing the amount of revenue collected by the government.


Testimony of IRS Oversight Board Chairman Paul Cherecwich, Jr., before the Senate Committee on Appropriations Subcommittee on Financial Services and General Government Committee, 2008 TNT 75-52 (Apr. 16, 2008).

CRS Update, supra note 4 (noting that the U.S. Treasury’s comprehensive strategy for reducing the tax gap includes seven components, one of which is making a multi-year commitment to research); see also BNA, DAILY TAX REPORT, May 2, 2008, p. G-3. Additional resources for research, however, require budget increases. TIGTA Additional Actions Report, supra note 4, Memorandum at 2.
160 Testimony of IRS Oversight Board Chairman Paul Cherecwich, Jr., before the Senate Committee on Appropriations Subcommittee on Financial Services and General Government Committee, 2008 TNT 75-52 (Apr. 16, 2008).

161 Id.

162 TIGTA Additional Actions Report, supra note 4, at 7.


164 TIGTA Additional Actions Report, supra note 4, at 7.

165 See CRS Update, supra note 4.

166 CRS Update, supra note 4 (noting that the U.S. Treasury’s comprehensive strategy for reducing the tax gap includes seven components, one of which is continuing improvements in information technology); see also BNA, Daily Tax Report, May 2, 2008, p. G-3; TIGTA Additional Actions Report, supra note 4, at 7.

167 CRS Update, supra note 4 (noting that the U.S. Treasury’s comprehensive strategy for reducing the tax gap includes seven components, one of which is continuing improvements in information technology); see also BNA, Daily Tax Report, May 2, 2008, p. G-3; TIGTA Additional Actions Report, supra note 4, at 7.

168 CRS Update, supra note 4 (noting that the U.S. Treasury’s comprehensive strategy for reducing the tax gap includes seven components, one of which is continuing improvements in information technology); see also BNA, Daily Tax Report, May 2, 2008, p. G-3; TIGTA Additional Actions Report, supra note 4, at 7.

169 Id.


171 Id.

172 Id.


174 I.R.C. § 6103.

175 I.R.C. § 6103(a) (flush language) and (a)(1). How to modify the disclosure rules of I.R.C. § 6103 to permit shaming is beyond the scope of this article.

176 I.R.C. § 7431.

177 I.R.C. § 7431(c).
I.R.C. § 7213(a)(1) (“It shall be unlawful for any officer or employee of the United States or any person described in [I.R.C.] section 6103 (n) (or an officer or employee of any such person), or any former officer or employee, willfully to disclose to any person, except as authorized in this title, any return or return information (as defined in [I.R.C.] section 6103 (b)).”). Additionally, penalties for disclosure of confidential information by any officer or employee of the United States or any department or agency thereof, are subject to 18 U.S.C. § 1905. I.R.C. § 7213(e)(2).

But see, Jeremiah Coder, OPR Makes Changes to Public Disclosure of Sanctions, 2008 TNT 103-1 (May 28, 2008) (Circular 230 disciplinary actions are going to be made public more often and will contain the section of Circular 230 that was violated, a brief description of the misconduct, and the range of sanctions possible for ethical violations).


Notably, “the GAO has issued a number of reports on the failure of [government] contractors to pay taxes.” Id. As of June 20, 2005, General Service Administration contractors had tax debts totaling approximately $1.4 billion. Id. As of fall 2003, Defense Department contractors had tax debts totaling approximately $3 billion. Id. As of the end of fiscal year 2004, contractors hired by federal civilian agencies had tax debts totaling at least $3 billion. Id.


Id. (based on statements of senior IRS officials at a conference on cross-border tax issues). In preparation for an audit, the IRS will do a lot of research on the taxpayer and a lot of advance planning. Id.

2008 TNT 101-10 (May 23, 2008).

TIGTA Additional Actions Report, supra note 4, at 9; CRS Update, supra note 4.

TIGTA Additional Actions Report, supra note 4, at 9; CRS Update, supra note 4 (noting that the U.S. Treasury’s comprehensive strategy for reducing the tax gap includes seven components, one of which is enhancing taxpayer service (to reduce unnecessary contacts by the IRS with taxpayers who want to comply with the law)); see also BNA, DAILY TAX REPORT, May 2, 2008, p. G-3.

“Since the inception of the Internal Revenue Code, there have been calls for simplification. For example, a March 1920 New York Times article discussed the complexity of the tax system . . . . The Joint Committee on Taxation was founded in 1926 to make recommendations to simplify the tax code.” TIGTA Additional Actions Report, supra note 4, at 18.
The U.S. Treasury’s comprehensive strategy for reducing the tax gap includes seven components, one of which is simplifying the tax law (to reduce unintentional errors caused by lack of understanding). See CRS Update, supra note 4; see also BNA, DAILY TAX REPORT, May 2, 2008, p. G-3.

I.R.S. News Release, IR-2008-63 (Apr. 22, 2008) (“One of the biggest challenges faced by people starting out in business is understanding and meeting their tax filing requirements. . . . We want new small business owners to know that the IRS has resources to help them learn about their federal tax responsibilities and avoid common pitfalls.”) (statement of Kathy Petronchak, IRS commissioner of Small Business/Self-Employed operating division.).

TIGTA Additional Actions Report, supra note 4, at 10.


BNA, DAILY TAX REPORT, Apr. 17, 2008, p. G-7 (concern raised by Senator Sam Brownback).

Simplification also may reduce the number of taxpayers considering noncompliance. The U.S. Treasury’s comprehensive strategy for reducing the tax gap includes seven components, one of which is simplifying the tax law (to reduce opportunities for intentional evasion). See CRS Update, supra note 4; see also BNA, DAILY TAX REPORT, May 2, 2008, p. G-3. “Taxpayer service is an important component in combating the tax gap. However, it can address only the noncompliance that is related to unintentional errors caused by the complexity and confusion surrounding the tax laws.” TIGTA Additional Actions Report, supra note 4, at 17-18.


2008 TNT 94-33 (May 13, 2008).

TIGTA Additional Actions Report, supra note 4, at 4.

CRS Update, supra note 4; see also BNA, DAILY TAX REPORT, May 2, 2008, p. G-3.

2008 TNT 101-10 (May 23, 2008).

Id. “Offering assistance to taxpayers who do not intend to comply will have no effect on the voluntary tax compliance rate and thus not reduce the tax gap.” TIGTA Additional Actions Report, supra note 4, at 18.


BN A, DAILY T AX REPORT, May 14, 2008, p. G-3; TIGTA Additional Actions Report, supra note 4, at 10; see also Jeremiah Coder, OPR Makes Changes to Public Disclosure of Sanctions, 2008 TNT 103-1 (May 28, 2008) ("The publication of particular violations and their outcomes should provide very useful guidelines with respect to informing practitioners of appropriate conduct and getting a flavor of the consequences of violations").

CRS Update, supra note 4.


TIGTA Additional Actions Report, supra note 4, at 16.


Remarks of IRS Commissioner Douglas Shulman before the American Bar Association, BNA, DAILY TAX REPORT, May 13, 2008, TaxCore; 2008 TNT 92-69 (May 9, 2008); 2008 TNT 92-69 (May 9, 2008); see also BNA, DAILY TAX REPORT, May 12, 2008, p. G-1 (“Commissioner of Internal Revenue Douglas Shulman May 9 said he plans to stress both a vigorous enforcement program and world-class service during his five-year tenure”).


Testimony of IRS Oversight Board Chairman Paul Cherecwich, Jr., before the Senate Committee on Appropriations Subcommittee on Financial Services and General Government Committee, 2008 TNT 75-52 (Apr. 16, 2008).