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House Ways and Means Committee
Subcommittees on Oversight and Select Revenue Measures
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

RE: Subcommittee Hearing
"Minding the Tax Gap; Improving Tax Administration for the 21st Century"
Hearing scheduled for Thursday, June 10, 2021

Dear Committee Members:

The undersigned trade associations represent banks, credit unions and related financial institutions of all sizes. We thank you for your interest in better understanding and addressing the causes of the "Tax Gap," and we share your interest in ensuring taxpayers honor their tax obligations. Our associations agree the government must have adequate funding and resources to promote compliance with our Nation's tax laws, and to that end, our members already provide significant data to the Internal Revenue Service (IRS) and other governmental units. However, recent proposals to create new reporting requirements for financial institutions appear to impose cost and complexity that are not justified by the potential, and highly uncertain, benefits. President Biden's American Families Plan includes the following:

> "The President's proposal would change the game—by making sure the wealthiest Americans play by the same set of rules as all other Americans. It would require financial institutions to report information on account flows so that earnings from investments and business activity are subject to reporting more like wages already are."[1]

On May 28th, 2021, the Administration released its fiscal 2022 budget proposal and related "Green Book[2]" At this time, we understand and appreciate there are not detailed official proposals on how the additional reporting requirements and related administration would work. That said, the limited additional information included in the Green Book suggests that this new regime could be exceptionally expansive and comprehensive, covering the accounts of most Americans, rather than only the "wealthiest," as described in the American Families Plan.

As the Subcommittees begin to consider the feasibility and advisability of this proposal, we encourage you to carefully assess the costs and benefits of imposing a new level of bureaucracy and personal data collection on our already over-complicated tax reporting structure. This proposal will have real costs, not only for government, but also for financial institutions, small businesses, and individual taxpayers. Strengthening IRS funding and overhauling outdated

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[1] See "Fact Sheet: The American Families Plan" The White House Briefing Room, April 28, 2021 https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/

[2] See "General Explanation of the Administration's Fiscal Year 2022 Revenue Proposal" https://home.treasury.gov/policy-issues/tax-policy/revenue-proposal

technology to use existing information reporting to facilitate *targeted* auditing of questionable tax returns is a much more efficient and effective approach to closing the tax gap.

Financial Institution Reporting is Already Robust.
Considering all the existing tax and other compliance reporting responsibilities already borne by the financial services industry (Forms 1099, Schedule K-1s, Suspicious Activity Reports, Currency Transaction Reports, FBARs, etc.), we have reservations regarding the efficacy of yet another reporting requirement. For example, earnings from investments, including brokerage and retirement accounts, is already subject to comprehensive information reporting. The existing reporting captures all taxable events, including sale and distributions, via, amount others, Forms 1099-INT, 1099-DIV, 1099-B 1099-R and 5498.

We respectfully suggest that further cost benefit analysis is necessary before moving forward with this proposal. For example, it is not clear that the proposed information reporting requirement would materially improve the IRS's ability to identify non-reporters or generate deterrence for non-reporting over and above the tools already at their disposal. We urge policymakers first to ensure that the existing framework of information collection and oversight is being fully utilized before adopting new requirements as this proposal could give rise to millions of new Forms 1099. A recent GAO report suggests some existing data is not used due to resource constraints.[3] Further, in testimony before the Senate Finance Committee, fmr. IRS Commissioner Rossotti stated, "For example, the IRS today cannot efficiently evaluate information on 40 million K-1 forms, on the 1099-K reports from payers, or on submissions required by FATCA. Modern technology can effectively use this information to identify potential deficiencies."[4]

In addition, previously enacted policy initiatives aimed at helping to close the tax gap are already at work and likely starting to have an impact. For example, hundreds of millions of dollars have been expended to comply with the Foreign Account Tax Compliance Act (FATCA), which requires reporting on foreign bank accounts designed to address one of the main sources of unreported and underreported income.

Creating a New Reporting Structure is Not as Simple as it Sounds.
The costs and other burdens imposed to collect and report account flow information could surpass the potential benefits from such a reporting scheme. New reporting would appear to require material development costs and process additions for financial institutions, as well as significant potential reconciliation and compliance burdens on impacted taxpayers. For example, reporting total gross inflows and outflows would require a new reporting paradigm for depository institutions, which necessitates system changes to collect the information. The contemplated reporting appears to be required for virtually all accounts, even loan accounts and account transfers. Further, there would be an expansion of the types of entity account holders subject to reporting, including corporations. Finally, the proposal is unlike current 1099 reporting in that the number can not be simply inserted into the clients' tax returns. The addition

[3] GAO Report 21-102; Tax Administration "Better Coordination Could Improve IRS's Use of Third-Party Information Reporting to Help Reduce the Tax Gap" (December, 2020).
[4] See "Testimony of Charles O. Rossotti before the Senate Committee on Finance" https://www.finance.senate.gov/imo/media/doc/SFC%20written%20submission%20final05082021.pdf

of gross receipts and withdrawals is likely to substantially increase tax preparation time and costs for a large number of taxpayers. In sum, these changes would be significant and complex.

System changes needed to address the myriad challenges that arise when trying to apply a new statutory construct to the complex reality of different account types, ownership and use structures would be very substantial. A few preliminary hurdles include:

- Designing system capabilities to capture gross inflows and outflows that satisfy the prescriptive schema for information returns
- Identifying accounts based on taxpayer identification numbers
- Defining the entities and account holders within scope of the statute
- Navigating privacy concerns related to joint accounts
- Specifying definitions for beneficial owners, DBA's (Doing Business As), and "control" of an account
- Reconciling business and personal transactions that are comingled in single accounts
- Implementing any de minimus protocols for reporting

While the Green Book does not include a specific requirement for taxpayers to "reconcile" whatever information is provided to them and the IRS by financial institutions, it is unreasonable to assume this new reporting structure would not create a significant burden on individuals and businesses – the majority of whom will have nothing inherently suspicious about their returns. Taxpayers will want to understand what is being reported so they can be prepared for any inquiries, should they come. The additional compliance responsibilities and complexity of implementation should be carefully considered before these proposals move forward.

<u>Benefits of Enhanced Account Flow Reporting are Uncertain and Estimates May Be Exaggerated.</u>

Given the substantial burden that this proposed reporting requirement could create on businesses, individual taxpayers and financial institutions, it is imperative that the benefits of implementation materially outweigh the costs and risk associated with this large-scale collection of sensitive personal financial information. Some of the estimates that have been used to derive the expected benefits from this proposal, however, may be outdated and misleading. For example, one study cites foreign bank accounts as a key source of the underreporting of income, though its underlying data were from a time period that preceded enactment of FATCA requirements to report such accounts.[5] Another study acknowledges the savings it projects are "optimistic" compared to those of the Congressional Budget Office ("CBO") and encourages the CBO and the Joint Committee on Taxation ("JCT") to weigh in on its policy recommendations.[6] We agree that it will be critical, therefore, for the CBO and JCT to independently assess the assumptions and data underlying the forecasted benefits of this proposal.

<u>The Scope and Scale of this Proposal will have Significant Privacy and Data Protection Ramifications.</u>

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[5] See Guyton, Langetieg, Reck, Risch, Zucman. "Tax Evasion At The Top Of The Income Distribution: Theory And Evidence" https://www.nber.org/papers/w28542.

[6] See Sarin, Summers. "Shrinking The Tax Gap: Approaches and Revenue Potential" https://www.nber.org/system/files/working_papers/w26475/w26475.pdf

If enacted, this proposal would require financial institutions and other providers of financial services to track and submit information on every account above a $600 *de minimis* threshold. Rather than a targeted program, this proposal would create a dragnet, collecting the financial information of most Americans and requiring significant resources to build, police, and maintain. Policymakers must consider how account-holder data would be protected and whether a program of this scale and scope infringes on the American people's reasonable expectation of privacy. As noted in the Administration's Tax Compliance Agenda, the IRS experiences 1.4 billion cyberattacks annually. Unfortunately, the IRS has a continued track record of data breaches and continues to deal with the fallout of identity theft and filing of false tax returns. Adding an entirely new set of data without first ensuring the security of existing IRS records will only compound the IRS's systemic problem and expose even more customer data.

In addition to the challenges associated with protecting this new data, policymakers should consider the potential unintended consequences of leveraging bank relationships to execute such a large-scale and detailed reporting regime. Privacy concerns are already cited as one of the top reasons that individuals choose not to open bank accounts.[7] A reporting regime of this magnitude could exacerbate the wealth gap in this country by pushing those households on the cusp of banking services back into the unbanked and underbanked population.

<u>Providing Enhanced Resources for IRS Audits is a More Effective, Efficient, and Fair Approach.</u>
Assuming there were enhanced resources for audits, we expect it would be standard protocol for IRS auditors to ask taxpayers to do exactly the type of account flow reconciliation apparently contemplated under the new regime. This analysis would be based on information the taxpayers already have in their possession (e.g., bank statements). Asking financial institutions to perform this role at scale, piecing together a picture of hundreds of millions of individual taxpayers' accounts, is inefficient and indirect.

As we stated earlier, we support efforts to increase compliance so that all taxpayers meet their responsibilities, but putting financial institutions in the position of reporting more information on their account holders is not the answer.

We welcome any opportunity to further discuss our policy concerns on this matter.

Sincerely,

American Bankers Association
Community Development Bankers Association
Consumer Bankers Association
Credit Union National Association
Independent Community Bankers of America
Mid-Sized Bank Coalition of America
Mortgage Bankers Association
National Association of Federally-Insured Credit Unions
National Bankers Association

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[7] Federal Deposit Insurance Corporation, "How America Banks: Household Use of Banking and Financial Services [-] 2019 FDIC Survey," p. 17

Securities Industry and Financial Markets Association
Subchapter S Bank Association