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Senate Budget Committee Holds Tax Hearing on Wealthy Individuals

At the November 8 Senate Budget Committee hearing, “Fairness and Fiscal Responsibility: Cracking Down on Wealthy Tax Cheats,” Democrats and some witnesses defended the Internal Revenue Service (IRS) funding boost enacted in the Inflation Reduction Act (IRA) as allowing the agency to expand audits to additional types of entities that have had little audit coverage in the past, including complex partnerships, which some Republicans suggested may be an overreach. The hearing comes as House Republicans proposed a rescission of more than \$14 billion of the IRS funding in a national security supplemental bill – despite the fact that clipping funding for the agency is scored as a revenue loss, not gain – and a day before the Senate Finance Committee will conduct its own hearing on the taxation of high-wealth individuals.

Chairman Sheldon Whitehouse (D-RI) has been critical of the House proposal, saying, “Republicans never miss a chance to protect their billionaire donors. As if conditioning aid to Israel on this gift to wealthy tax cheats wasn’t bad enough, what they claim will ‘pay for’ the aid will actually add \$12.5 billion to the deficit, nearly doubling the bill’s total cost.” Ranking Member Chuck Grassley (R-IA), who previously targeted some forms of tax evasion as a former Finance Committee chairman, said, “The overwhelming emphasis on tax enforcement taken by the Inflation Reduction Act will come at tremendous costs to innocent small business owners and others caught in the IRS’s audit dragnet.”

Witnesses:

- Natasha Sarin, formerly of the Biden Treasury Department and now a Yale professor
- Nathaniel Hendren, Professor Of Economic and Co-Founder Of Policy Impacts, Massachusetts Institute Of Technology
- Chris Edwards, Kilts Family Chair In Fiscal Studies, Cato Institute

Testimony highlights:

- Sarin said, “Before the IRA investments in the IRS, the agency hadn’t meaningfully modernized tax processing or taxpayer service in the last several decades,” and the “IRS has not had resources to devote to measuring partnership evasion, let alone thinking about how best to address it, and indeed, today the agency’s partnership audit rate is approximately 0%.”
- Hendren cited a paper estimating that “marginal expenditures on in-person audits directed towards top-earning taxpayers, those above the 90th income percentile, are likely to return at least \$12 in revenue for each \$1 in costs.”
- Edwards said, “Some policymakers favor spending more on Internal Revenue Service (IRS) enforcement to raise added revenues. But that approach would create collateral damage on taxpayers and the economy. Tax compliance is important, but the Biden administration’s plan to more than triple IRS enforcement spending over the next decade is overkill.”

Under questioning from Chairman Whitehouse, Sarin said the IRS can measure the individual tax gap but has had “no real capacity to measure the corporate tax gap, the partnership tax gap, and the digital assets tax gap,” making the total tax gap potentially as high as a \$1 trillion per year. The new IRA funds are going to enable IRS to capture and measure those types of evasion that happen at the top of the income distribution, through partnerships and offshore bank accounts, that today the agency “just isn’t able to see.”

Asked if auditing complex partnerships of the type being described in the hearing will create more headaches, Sarin said pass-throughs are taxed at the individual level and IRS must peel back the layers: there are partnerships that own partnerships who are owned by foreign entities, and there is somewhere individual income liability “that sits in a structure like that.” She said compliance issues posed by complex partnerships, which in some cases are structured to hide income from the IRS, are difficult to unpack without the “right team of experts spending time on this type of work.”

Senator Mitt Romney (R-UT) said the idea that Congress is going to reduce the number of IRS agents and audits is wrong, and perhaps a ploy to appeal to some voters. Still, he said, complex structures aren’t necessarily to cheat on taxes, it is “just the reality of what happens if you are making multiple investments.” He provided the example of an entity that buys houses: buys 1,000 homes, there are unique situations for each one perhaps, with different purchase prices, different investors joining in, perhaps a foreign investor or not-for-profit organization. “That’s the complication of investments made by entities that are making lots of different investments in lots of different places,” he said.

Senator Ron Johnson (R-WI) bemoaned the tax code as “completely irrational” and ripe for simplicity to increase compliance, rather than increasing the number of IRS agents. Edwards said modern businesses have gotten complex, including from “corporations making extremely sophisticated structures to avoid tax.” He said these are not things that are illegal, but “the tax code is so gray, they push the limits.”

Senator Jeff Merkley (D-OR) suggested some Republicans don’t want to enforce the tax code. Sarin said it is not just revenue raising but a matter of fairness: the law should apply across the income distribution spectrum and the wealthy and corporations shouldn’t have tools to evade taxes that the rest of the American people don’t have, she said.

Senator Mike Lee (R-UT) said Democrats conflate illegal tax evasion with legal measures that taxpayers may use to reduce tax liability. “There is a difference between those two things,” he said. Many call for “confiscatory tax policies” that are unconstitutional, like the wealth tax, or extremely complex, including to tax gains that haven’t yet been realized as income, Lee said. A wealth tax, taxing unrealized gains, and increased scrutiny of partnership taxation have all been proposed in the Senate by Finance Committee Chairman Ron Wyden (D-OR) and others.

Under questioning from Senator Mike Braun (R-IN), Sarin said tax reform could play a role in taming the deficit, and she mentioned a proposal she has published with Kim Clausing, another former Treasury official. (<https://www.hamiltonproject.org/publication/policy-proposal/the-coming-fiscal-cliff-a-blueprint-for-tax-reform-in-2025/>)

In a practice he has employed at previous hearings to challenge social media posts by witnesses, Senator John Neely Kennedy (R-LA) questioned Sarin about a post regarding the House Republican proposal for a rescission of more than \$14 billion in IRS funding as part of a national security supplemental bill. Senator Tim Kaine (D-VA) defended the comments attributed to Sarin and said it appears the House IRS proposal may reflect an attitude among Republicans there that “we think we can jam the Senate” because they support aid to Israel and may be forced to rescind IRS funding in exchange.



The staff of the Joint Committee on Taxation has prepared a document, "Present Law And Background On The Income Taxation Of High Income And High Wealth Taxpayers," ahead of the Finance hearing.
<https://www.jct.gov/publications/2023/jcx-51-23/>

Testimony from the Budget Committee hearing is at: <https://www.budget.senate.gov/hearings/fairness-and-fiscal-responsibility-cracking-down-on-wealthy-tax-cheats>