

**Transcript of Remarks by Senator Kent Conrad (D-ND)
at Senate Budget Committee Hearing
on the Growing Tax Gap and Strategies for Reducing It
January 23, 2007**

Opening Remarks

The hearing this morning is about the growing tax gap and strategies for reducing it. The tax gap, as we all know, is the difference between what is owed and what is actually being paid. And we now know that according to the Revenue Service the tax gap is running at about \$350 billion a year. Let me repeat that. The tax gap is estimated by the Revenue Service to be \$350 billion a year.

That is money that should be in the coffers of the Federal government according to existing tax law. We're not talking about a tax increase here. We're not talking about increasing any rate. We're talking about collecting the money that is due and owed under the current law. The tax gap, I believe, is unfair to the vast majority of the taxpayers who pay what they owe. We know the vast majority of Americans do pay their taxes. The vast majority of companies pay what they owe. But we have a growing number of both individuals and companies that do not.

Unfortunately, our nation's budget picture is not good, as we see on the chart. Last year the deficit was \$248 billion, but the debt rose by \$546 billion.

While increased spending has contributed to the deficit and debt, the dramatic decline in revenues has been an even larger factor. In fact, real revenues – that is adjusted for inflation - have experienced little growth since 2000 as we see in this chart. It is true, and my colleague will perhaps reference, that the last several years we have seen healthy growth in revenues, but if we go back to 2000 we see that we are only now getting back to the revenue base we had then.

That brings us to our hearing today on the tax gap. The growth of the tax gap is one of the factors contributing to the revenue drop. According to the IRS's latest estimate, the tax gap in 2001 was \$345 billion for that year alone.

To put a \$345 billion tax gap in some perspective, consider that it is almost \$100 billion larger than the size of the entire deficit in 2006. While we will never be able to close the tax gap entirely – make no mistake, we understand we aren't going to collect all \$345 billion a year; there is always going to be some tax gap – but it is clear that much more can and should be done.

In testimony before this Committee, the IRS Commissioner (Mark Everson) stated: "...[Y]ou can clearly reduce [the tax gap] by \$50 or \$100 billion, without changing the way the government interacts with its citizenry." In other words, we can close a considerable amount of the gap without resorting to draconian or intrusive measures.

It is important to remember that the added burden placed on taxpayers from the tax gap is very real. In her 2006 Annual Report to Congress, the National Taxpayer Advocate (Nina Olson)

wrote, and I quote: “Compliant taxpayers pay a great deal of money each year to subsidize noncompliance by others. ... [E]ach household was effectively assessed an average ‘surtax’ of about \$2,680 to subsidize noncompliance [in 2001]. That is not a burden we should expect our nation’s taxpayers to bear lightly.”

To close the tax gap, we need to enhance reporting and withholding requirements for certain taxpayers. We know that taxpayer compliance improves dramatically with increased reporting and withholding. For example, according to the Revenue Service, for income that is subject to substantial reporting and withholding requirements – such as wages and salaries, we see a 99 percent compliance rate. When reporting requirements are in place, we see a 91 percent compliance rate. But when there is neither, we see a sharp drop in the compliance rate – falling to less than 50 percent.

The other way to close the tax gap is through better enforcement by the IRS. In his testimony before the Budget Committee last year, the IRS Commissioner noted that: “The IRS yields approximately four dollars in direct revenue for every additional dollar spent in its enforcement efforts.”

We simply can’t bring the budget back to balance by looking only at spending, although we must certainly do that. In my judgement we can’t do it solely on the spending side, even with entitlement reform which is absolutely required. There is also going to have to be additional revenue. And I would strongly prefer that instead of talking about tax increases, that before we start talking about tax increases for anyone, we aggressively go after this tax gap. It is only fair and I think right.

Additional Selected Comments

On the question of how big the tax gap is, I believe it is much larger than \$345 billion. I have looked into how they made the estimates, and I don’t want to bore people with the details on how that was done, but I think honestly if you evaluate the way they made the estimates the likelihood is the tax gap is substantially bigger. First of all, that is a number from 2001. We’re at 2007. If we look back historically we have seen that the tax gap has grown inexorably, and in fact, has exploded in recent years. Second, if you talk to people in the accounting profession, they will tell you that what we call aggressive accounting has increased geometrically. That is, because of competitive pressures, accounting firms have become much more willing, if not eager, to engage in very aggressive accounting practices with respect to taxes that are due.

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There is a building down in the Cayman Islands, one five-story building that is the home to some 12-thousand companies – companies that are all claiming they are doing business out of that building. I have said it is the most efficient building in the world. It is a very modest building, but an amazing amount of business activity out of that building.

I think Mr. McIntyre you have hit on something here with respect to information from tax haven countries. There is tremendous leakage in those countries.

When I was Tax Commissioner of my state and for a time the chairman of the multi-state tax commission, I followed the transactions of one multinational corporation, and found that in the sale of grain, that grain had changed hands eight times before it left this country and then went off-shore and the last I was able to follow it, it was down in the Cayman Islands selling from one company to another. And it was amazing, no taxes were reported in this country, and although they showed tremendous profits in the Caymans, no taxes there because they didn't have any taxes.

I found when I was Tax Commissioner one oil company that showed losses at every step of the marketing chain in the United States, showed huge profits in the Cayman Islands with one employee, millions of dollars of profits, that's where they showed all their profits. That man is really a hard worker. He's down there producing millions in profits when thousands of employees in the United States produce none.

These are scams being run that are really unfair to the vast majority of people who are honest. I think Mr. Satagaj, you said it well, the fact is most people, I think a significant vast majority of Americans, pay what they legitimately owe; companies pay what they legitimately owe to the extent they understand it. But there are a group out there, unfortunately I think it is a growing group, who think they can get away with murder. And they are shoving the burden onto all of the rest of us.