

United States Senate Committee on Finance

For Immediate Release

Thursday, Oct. 19, 2006

Grassley, Baucus Release, Will Review More JCT Options to Close the Tax Gap

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, and Sen. Max Baucus, ranking member, today released a new set of discussion options for closing the tax gap from the non-partisan congressional Joint Committee on Taxation and said they will review the options carefully. The tax gap is the difference between taxes owed and taxes paid, estimated at \$345 billion per year. The committee could choose whether or not to endorse any of the new options in the coming months. The senators are interested in receiving public comment on the recommendations by the close of business on Friday, Dec. 1, 2006, e-mailed to taxgap@finance-rep.senate.gov.

“There’s no magic bullet for closing the tax gap,” Grassley said. “There are many sources for the gap. We need to keep finding ways to get taxpayers to pay what they owe and keep chipping away until the tax gap is as small as possible. This new report gives the committee new options to review in the coming months. We may not end up endorsing all of them, but this document is a good starting point for discussion.”

Baucus said, “The Joint Committee on Taxation has identified some useful opportunities for closing the tax gap. The tax gap drains \$345 billion from America’s economy every year, and a good look at these options will help the Committee decide how best to move forward. We’ve got to keep moving the ball on the tax gap. The Treasury Department and IRS should fully join the fight with a more complete strategy as well.”

The latest batch of recommendations came at the senators’ request as a follow-up to the Joint Committee on Taxation’s 2005 report, “Options to Improve Tax Compliance and Reform Tax Expenditures” (JCS-2-05). Grassley and Baucus successfully enacted several of those recommendations in bills, now law, including the *Tax Increase Prevention and Reconciliation Act of 2005*. Other recommendations they pursued received Senate passage but not House passage.

A Finance Committee staff summary of the new report “Additional Options to Improve Tax Compliance” follows here. The report is attached.

IMPROVED INFORMATION REPORTING

Reporting Requirements for Basis of Publicly-Traded Securities: Brokers would be required to report to the client and to the IRS the adjusted basis of publicly traded securities sold during the preceding taxable year. Currently, brokers are required to report gross sale proceeds to the IRS, but not basis. The proposal would reduce the underreporting of capital gains from publicly traded securities transactions resulting from inflated basis amounts. An IRS study estimates that the gross tax gap

attributable to all underreported capital gains was \$11 billion in 2001, and other estimates are even higher. This proposal would address the portion of the capital gains tax gap attributable to publicly traded securities transactions.

Reporting Requirements for Real Estate Taxes: The proposal contains two options for information reporting of real estate taxes paid: 1) would require state and local governments to report to taxpayers and the IRS the amount of real estate taxes paid, or 2) would require mortgage lenders to report to taxpayers and the IRS the amount of real estate taxes paid through escrow accounts. Present law does not require information reporting for real estate taxes paid. This proposal would reduce deductions taken for assessments, services and other non-deductible charges that frequently are combined with real estate tax billings.

Reporting Requirements for Proceeds of Auction Sales: Broker information reporting requirements would be expanded to include proceeds from property sold at auctions, including collectibles or motor vehicles. Presently, there is no third party information reporting for property sold at auction. The proposal would reduce underreporting and non-reporting of proceeds resulting from auction sales.

Reporting Requirements for Mortgage Interest: Present law information reporting by mortgage holders to taxpayers and the IRS would be expanded to identify whether interest paid was in connection with a financing or refinancing, and whether debt proceeds exceed the \$100,000 home equity limit. Current reporting forms display the aggregate amount of interest paid to the lender. The proposal would make it easier for taxpayers and the IRS to calculate the correct amount and timing of interest deductions and reduce erroneous deductions for non-deductible items like prepaid interest (points) paid in connection with a refinancing.

Reporting Requirements for Individuals with an Interest in Offshore Bank Accounts and Offshore Trusts: The proposal would impose a due diligence requirement on income tax preparers to determine whether a taxpayer is required to file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), or Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipts of Certain Foreign Gifts. In addition, JCT recommends revising the FBAR form to update terminology and clarify filing requirements. Treasury estimates that current FBAR compliance rate may be less than 20%. The proposal would improve the ability of the IRS to detect unreported income and abusive transactions resulting from the use of offshore accounts.

ENHANCED TAX ADMINISTRATION

Modify Amounts Subject to Self-Employment Tax for Partners and Subchapter S Corporation Shareholders in Personal Service Businesses: The proposal would apply the present law rule that a general partner's distributive share is subject to employment taxes to all types of partners and S corporation shareholders with income from service businesses. The proposal also would include members of an LLC or other entity that are treated as a partnership for Federal income tax purposes. Present law treats income from general partners, limited partners and Sub S shareholders differently for employment tax purposes. The proposal would eliminate "choice of business form" decisions that result in substantially different tax liability for otherwise similar types of service trades or businesses.

Denial of Deductions and Credit with Respect to Untimely Returns of Nonresident Aliens and Foreign Corporations: The proposal contains two options to clarify and define timely filing of tax returns by foreign persons: 1) would specify by statute a fixed date or event after which a foreign person's deductions or credits are denied, or 2) would specify by statute that a foreign person's deductions or credits are denied when tax returns are not timely filed, and delegate to Treasury the authority to define what is meant by "timely". IRS regulations set forth specific periods of time in which foreign persons may timely file and claim deductions and credits against income but a recent Tax Court decision, *Swallows Holding Ltd.*, determined the regulations were invalid to the extent that they adopt a timely filing requirement. A clear definition of the term "timely" would encourage foreign taxpayers to file US tax returns and pay US taxes.

Compliance with Earnings Stripping Provision: Corporate taxpayers would be required to report to the IRS whether any portion of their interest deductions were limited under the IRC section 163(j) earnings stripping provision, as well as additional details explaining the limitation. Present law restricts the ability of US corporations to reduce their income taxes by deducting interest expense paid to related parties located offshore (or to unrelated parties with respect to debt guaranteed by related parties), but it is difficult to determine whether the law is being applied properly. The proposal would make it more difficult for corporations to conceal the use of earnings stripping to reduce their US tax bill by deducting excessive interest expense paid to foreign related parties (or to unrelated parties with respect to debt guaranteed by related parties).