Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

August 17, 2021

MEMORANDUM

TO: [redacted]

FROM: Thomas A. Barthold Thomas A. Barthold

SUBJECT: Distributional Information

This memorandum responds to your request for distributional information on a proposal in Treasury's "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals" (the "Greenbook"). The proposal, "Introduce Comprehensive Financial Account Reporting to Improve Tax Compliance," requires financial institutions to report inflows and outflows for every account with at least $600 of inflows or outflows in a year, for tax years beginning after December 31, 2022. Although these inflows and outflows do not directly correspond to any line items on tax returns, the proposal is estimated to reduce underreporting of income, particularly on income subject to little or no information reporting, such as individual business income, self-employment income, and small C corporation income. We estimate that the proposal would raise $206 billion over the 2022-31 budget window.

We are unable to provide distributional effects for this proposal because we do not impute unreported income to our individual tax model, in part because the distribution of unreported income is not well identified. Instead, we provide some distributional information on the tax gap attributable to the types of taxpayers that might be most affected by this proposal. In particular, underreporting of nonfarm proprietor income, *i.e.*, Schedule C income, was estimated to contribute $68 billion to the annual $245 billion individual income tax underreporting tax gap for tax years 2011 to 2013.[1] Underreporting of Schedule C income also contributes heavily to the $45 billion self-employment (SECA) tax underreporting tax gap for those same years.[2]

The table below presents a distribution of estimated tax assessments from representative random audits related to underreporting of Schedule C income. To estimate these tax assessments, income adjustments from these audits were multiplied by estimated average marginal tax rates.[3] As the table shows, more than half of the assessed amounts are estimated to

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[1] Table 5, Internal Revenue Service, *Tax Gap Estimates for Tax Years 2011-2013* (Pub. 1415), September 2019.

[2] Table 2, *Ibid.*

[3] The random audits were done by the IRS National Research Program for tax years 2006-2014. Income adjustments from these audits are presented in tables A3 and A5, Jason DeBacker, Bradley Heim, Anh Tran, and Alexander Yuskavage, "Tax Non-compliance and Measures of Income Inequality," *Tax Notes Federal*, February 17, 2020, pp. 1103–1118. The estimated marginal tax rates are from the Joint Committee staff's individual tax model and combine income and SECA tax rates.

come from taxpayers with reported income between zero and $50,000.[4] To the extent that taxpayers with sole proprietor income tend to have lower income than taxpayers with partnership or S corporation income, the distribution of the tax assessments related to underreporting of Schedule C income might not represent the distributional effects of the Green Book proposal. To provide a fuller picture, the table also presents a distribution of estimated tax assessments related to underreporting of Schedule E income.[5] Many random audits of Schedule E income did not include entity-level audits. Entity-level audits were likely more common among smaller, single-owner businesses.[6] Thus, the Schedule E distribution below is incomplete and could skew toward lower incomes relative to a hypothetical distribution resulting from random entity-level audits.

The distributions below are grouped by reported adjusted gross income and therefore skew toward lower-income taxpayers relative to distributions done by true income (reported income plus unreported income). However, when audit adjustments are added to reported income, affected taxpayers tend to remain in the reported income group or move up only one income group.[7]

Percentage of Estimated Tax Assessments Relating to Underreporting of...

Reported Adjusted Gross Income (2010 dollars)	**... Schedule C income**	**... Schedule E income**
Less than $0................................	5%	6%
$0 to $50,000...............................	52%	34%
$50,000 to $100,000......................	21%	25%
$100,000 to $200,000....................	12%	13%
$200,000 to $500,000....................	6%	14%
$500,000 and over........................	4%	9%
Total......................................	**100%**	**100%**

Note: Details may not add to totals due to rounding.

[4] In 2010 dollars. The income ranges in the table are also in 2010 dollars.

[5] Schedule E encompasses many types of income, including partnership and S corporation income, but table A5 in DeBacker *et. al.* (2020) does not distinguish between them.

[6] See p. 11, Gerald Auten and David Splinter, "Comment: Tax Evasion at the Top of the Income Distribution: Theory and Evidence," August 5, 2021, available at http://www.davidsplinter.com/AutenSplinter-TaxEvasion.pdf

[7] Table 2, DeBacker *et. al.* (2020).