

Where's Waldo? The IRS's Search for High-Income Non-Filers

By Robert S. Horwitz and Sandra R. Brown*

Robert S. Horwitz and Sandra R. Brown examine the IRS's efforts to find high-income non-filers, defined as taxpayers who make more than \$100,000 annually.



Our pursuit of these high income non-filers provides an important service and shows respect to the majority of Americans who pay their taxes.¹

The U.S. income tax system operates under the basic assumption of voluntary compliance. Voluntary compliance requires Americans who earn a sufficient amount of income to file a timely and accurate tax return and pay the amount of tax shown due on their returns fully and on time.

Unsurprisingly perhaps, too many Americans do not voluntarily comply with their tax obligations and thus do not pay their fair share. While there are many reasons for this lack of compliance, for many Americans the reason is simply they see no reason to comply.

While all noncompliance contributes to the overall federal tax gap, high-income non-filers contribute to most of the non-filer tax gap. High-income non-filers are individuals who had a significant income but failed to file their income tax return.

There are hundreds of thousands of Americans who do not file their returns and, as a result, owe billions of dollars in back taxes to the federal government. How do we know this? In 2020, the Treasury Inspector General for Tax Administration (TIGTA) issued a report in which it was estimated that of the \$441 billion average annual tax gap between 2011 and 2013, \$39 billion can be attributed to the non-filers, of which \$37 billion (95%) is due to high-income non-filers.²

TIGTA was, however, not the only government agency in recent years reporting on non-filers. A 2019 GAO study showed a 40% decline in non-filer investigations since 2010, and that, by 2018, non-filer investigations by the IRS had declined to 800,000 for individuals and 400,000 for businesses.³

The reasons for non-filers' contributions to the tax gap are apparent. Absent voluntary compliance or an IRS audit, it is easy to see how one year of non-filing

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turns into five and then 10; like *Waldo*,⁴ these “missing” taxpayers become lost to the tax system and, therefore, to the IRS.

As the IRS's attention has increasingly focused on closing the tax gap, the reality for all non-filers, but especially for those who are classified as high-income non-filers, is that it is not a simple game of hiding to see if the IRS can find you before time runs out.

These “lost” taxpayers, however, are arguably a bigger compliance issue than simply looking at the numbers they contribute to the overall tax gap. For compliant taxpayers and the IRS, the issue is beyond simply increasing financial burdens, *e.g.*, dollars and cents. It affects how taxpayers view the IRS's ability to fairly and efficiently enforce the federal tax laws. Recognizing this very urgent problem, in February 2020, the IRS announced that it had begun a new program to address not simply non-filers, but more specifically, high-income non-filers and those taxpayers' contribution to the tax gap. So, what has the IRS accomplished on this front in the past 18 months and what can taxpayers expect from the IRS in this area of noncompliance in the near future?

But first, a bit of background: what is the “tax gap” and who are these “high-income non-filers.”

What is the “Tax Gap”?

The federal tax gap is a measure of taxpayer noncompliance, which is comprised of two estimates: the gross measure and the net measure of the gap.⁵ The gross federal tax gap is the difference between the total amount of federal taxes owed in a year and the total amount of those taxes paid voluntarily in full and on time. The net tax gap is the difference between all taxes owed and taxes paid after late taxpayer payments and taxes collected through IRS enforcement actions. The most recent report by the Congressional Research Service contained a table showing

TABLE 1. NET FEDERAL TAX GAP FROM 2001 TO 2013 (\$ BILLIONS)

Year(s)	Current Dollars	Constant 2020 Dollars	Net Taxpayer Noncompliance Rate ^a (%)
2001	\$290	\$423	13.7%
2006	\$385	\$493	14.5%
2008–2010	\$406	\$491	16.3%
2011–2013	\$381	\$431	14.2%

Source: Internal Revenue Service Tax Gap Estimates; and Bureau of Labor Statistics, Annual Average Consumer Price Indexes.

the fluctuation of the estimated net federal tax gap in 2020 dollars from 2001 to 2013 (*see* Table 1).⁶

Who Does the IRS Consider to Be a High-Income Non-Filer?

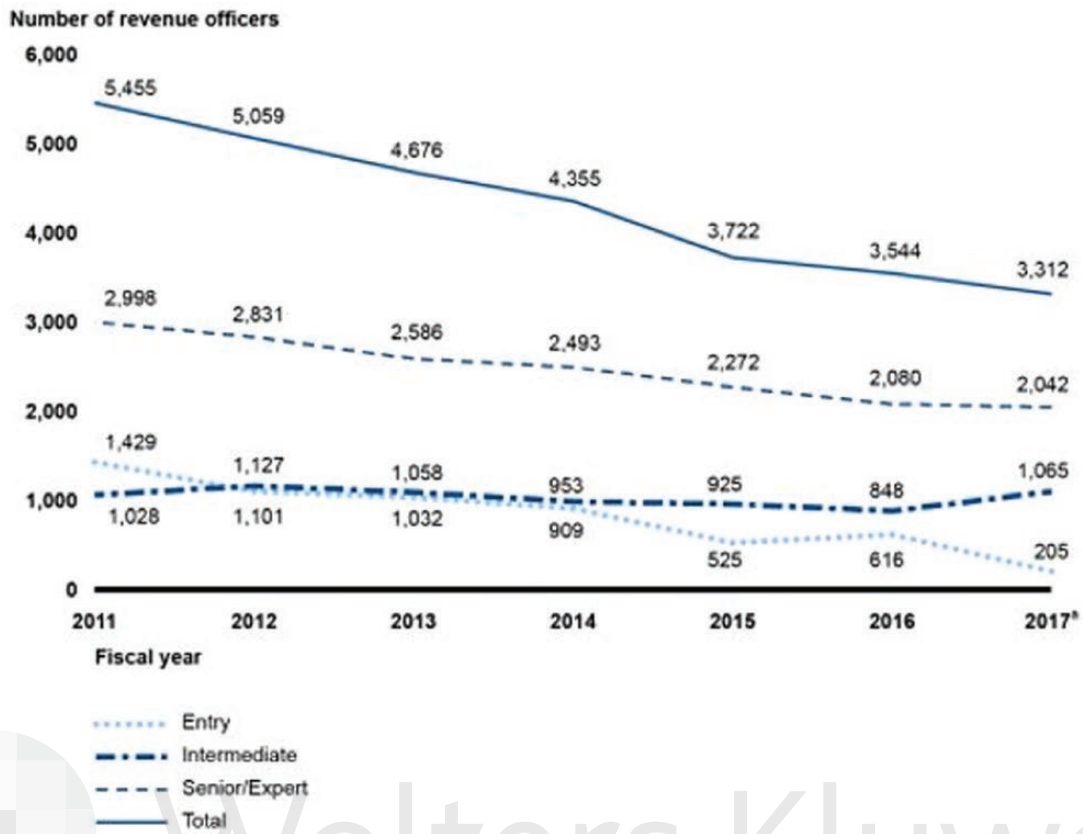
Contrary to what some might expect, according to the IRS, high-income non-filers are not just those individuals who are making millions of dollars of income each year. Rather, the bar is much lower. The IRS considers high-income non-filers to be taxpayers whose income equaled or exceeded \$100,000 during a tax year and failed to file an income tax return with the IRS.⁷

The IRS's Re-Focus on Finding High-Income Non-Filers

Non-filer investigations, or “taxpayer delinquency investigations” as they are called by the IRS, are generally the responsibility of IRS collection personnel. That means, it is IRS revenue officers and automated collection support employees who have historically handled the bulk of the IRS's non-filer enforcement work. So, when the IRS's number of revenue officers declined by 40% from 2011 to 2017, it was not a mere coincidence that, as reflected in the 2019 GAO analysis below in Figure 1, the IRS's non-filer investigations dropped likewise.⁸

Faced with such attrition, since 2010, the IRS prioritized collecting legally perfected debts, *e.g.*, tax debts for which the IRS has already obtained judgments or the taxpayer has self-assessed on a filed tax return, rather than pursuing debts which could be owed by non-filers (*see* Figure 2).⁹

FIGURE 1. REVENUE OFFICERS ON BOARD, BY SKILL LEVEL, FISCAL YEARS 2011–2017



Source: GAO analysis of Office of Personnel Management data. | GAO-19-176

That all changed in 2020.

As part of the IRS’s Small Business/Self-Employed Fiscal Year 2018–2022 IRS Strategic Plan and specifically its 2020 initiative to address the problem of high-income non-filers more aggressively, the IRS shifted resources in the collection area.¹⁰

The IRS identified and contacted taxpayers who made more than \$100,000 and had not filed a tax return before 2019 to ensure these taxpayers understood their obligation to file and pay income taxes. In some cases, the IRS sent delinquent return notices (IRS Notice CP59) to taxpayers asking them to file overdue tax returns, putting these taxpayers on alert for future action by the IRS. The enforcement effort also included direct visits to taxpayers in an initiative referred to as “High-Income Delinquent Filer (HiDeF) Sweeps.” These HiDeF Sweeps were handled by experienced revenue officers, often in teams of two IRS employees, making what were often unannounced visits. Most taxpayers who were contacted responded and thereafter either filed and paid their tax

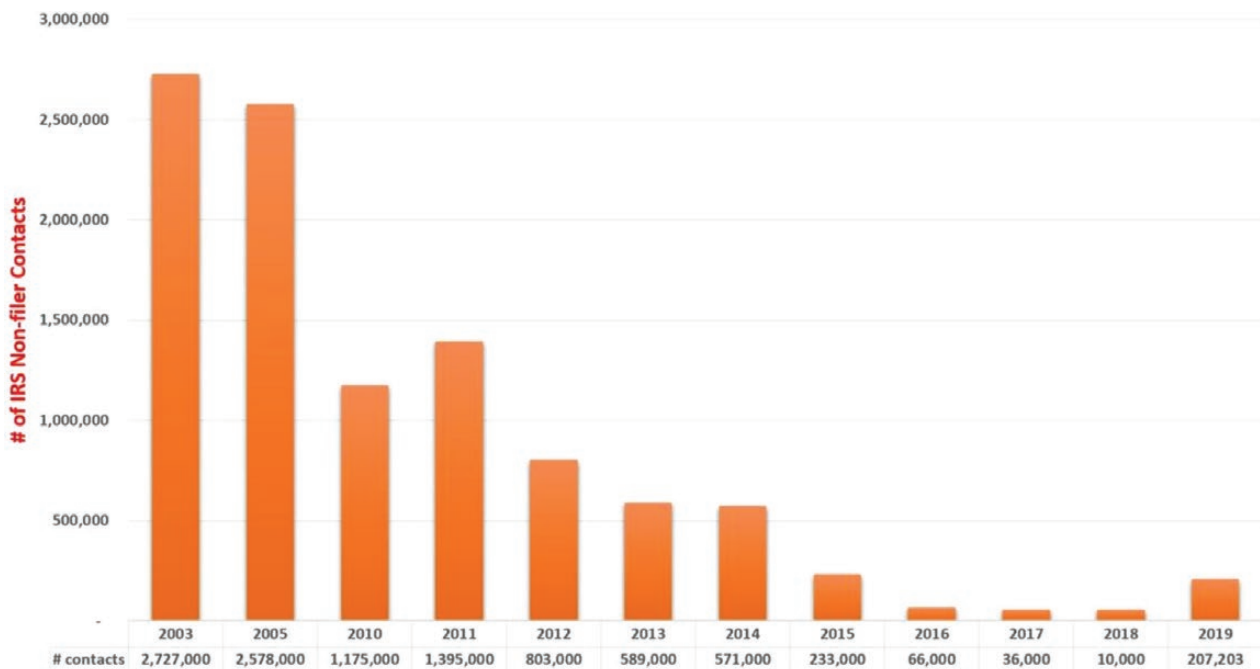
obligations or pursued opportunities to work with the IRS if they were unable to pay their tax debts fully at the time.¹¹

For non-filers who didn’t respond, the IRS announced that, as part of this higher-income enforcement effort, it was hiring more revenue officers and prioritizing the most egregious non-filer cases so the IRS could reach out to non-responsive taxpayers directly.¹²

The IRS’s 2020 Non-Filer Enforcement Initiative promised some of the following strategies to catch non-filing high net worth individuals and non-compliant businesses¹³:

- Increase the identification and case creation for individual and business non-filers. New cases would be assigned to IRS employees for appropriate resolution.
- **Automated Substitute for Return (ASFR) program.** Affected individual taxpayers who have not filed tax returns, but whose available income information shared with the IRS indicated a significant

FIGURE 2. IRS NON-FILER INVESTIGATIONS: 2003–2019



IRS Non-filer investigations peak in 2003- and are almost non-existent in 2015-2019. But new IRS non-filer initiatives in 2020 will change this trend. (IRS Data Books)

income tax liability, would see ASFRs filed by the IRS. As part of the ASFR program, the IRS would send notices to these taxpayers alerting them to the potential liability.

For those high-income non-filers, unless they voluntarily comply, they may be facing more than delinquent filing and payment obligations: they may also face criminal prosecution. Unlike Waldo, most people don't look good in stripes.

- **Campus automated 6020(b) program.** The campus automated 6020(b) program was designed to promote employment tax filing compliance by identifying business taxpayers with employment tax requirements who have not filed for a specific period. The IRS intended to ensure businesses complied with their

employment tax filing and payment requirements as part of an ongoing audit priority for the IRS.

- **Delinquent Return Refund Hold (DRRH) program.** As a matter of course, the IRS would hold an individual taxpayer's income tax refund when their account has at least one unfiled tax return within five years of the filed return.

The IRS also disclosed that some of the high-income non-filer cases from 2020 were referred to the then-new Office of Fraud Enforcement (OFE).¹⁴ Housed in the IRS's Small Business/Self-Employed Division, OFE focuses on compliance issues, including abusive tax shelters and other areas of potential fraud and abuse, such as non-filers, and to develop these cases for potential fraud referrals. One of the key roles of the OFE is to vet civil cases that may be more appropriately addressed by criminal enforcement and would thus be referred to the IRS Criminal Investigation Division to potentially be pursued criminally, including for failure to file, tax evasion and tax fraud. The IRS's disclosure of the involvement of OFE was a clear sign that high-income non-filers could be looking at more than a knock on the door by a civil compliance agent.

To this end, the IRS announced another initiative, "Operation Surround Sound," as the successor to the

HiDeF initiative. Operation Surround Sound targeted cases of egregious noncompliance with indicators of potential fraud as a collaboration between OFE, IRS Examinations, Operations, and Collections.

As the high-income non-filer initiative was well underway, the COVID-19 pandemic happened. This meant no more face-to-face visits by the IRS and, under the People First Initiative, a suspension of its non-filer initiative.¹⁵

The IRS, noting it was unable to actively work some cases, still identified about 1,500 of the most serious high-income non-filer cases, many of which, the IRS announced, had millions of dollars of suspected unclaimed incomes.¹⁶

What Tools Does the IRS Have to Find High-Income Non-Filers?

The value to the IRS of obtaining third-party information can't be overstated for the IRS's efforts not only to locate high-income non-filers, but also to close the tax gap. A July 2020 Congressional Budget Office report, in analyzing factors that affect the size of the tax gap, noted that third-party information reporting, or the lack thereof, has a direct and significant impact on the tax gap (*see* Figure 3, below).¹⁷

So, where does the IRS look when trying to find not only high-income non-filers but also the information

needed to determine the correct tax debt due by these taxpayers? The IRS frequently reminds taxpayers that it has a robust system to collect information that includes many sources to assist in its ability to identify possible tax issues, including multiple third-party sources and even taxpayers' previous filing histories.

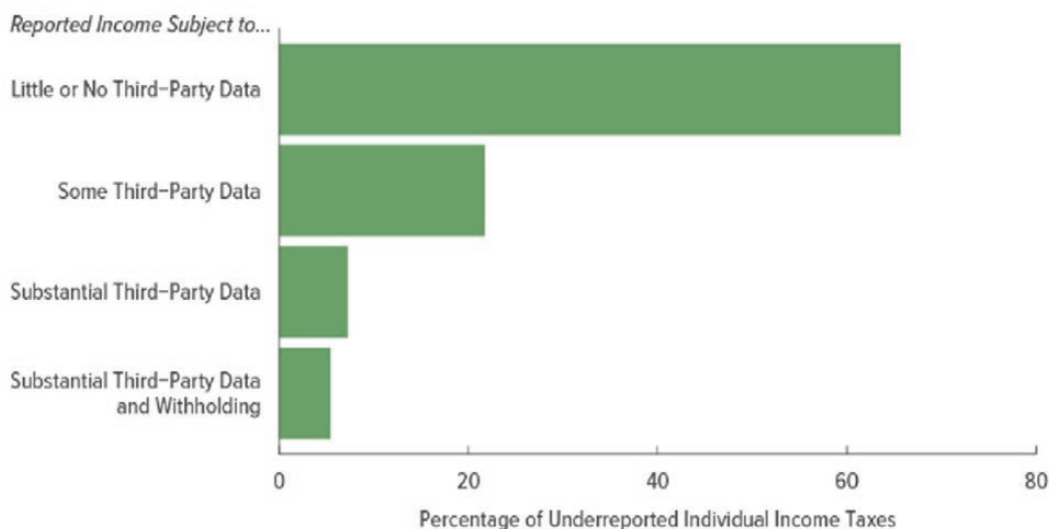
The IRS also has other legal avenues that provide potential information for cases, which includes:

- Information provided to the IRS whistleblower program,
- Information received from U.S. Attorney offices across the country,
- Ongoing investigations by other law enforcement agencies,
- Tips from colleagues, neighbors and friends, and
- Tax treaty and information exchange per case investigation requests.

As the IRS manpower numbers have declined in the past 10 years or so, and thus, the emphasis has turned to data analytics to help gain information to identify and locate non-filers, in this past year the IRS has renewed efforts to get Congress to give it more money for more hiring and to enact more legislation for more third-party reporting data. Increased third-party information reporting is viewed as one of the more efficient and resource-saving ways to increase the overall tax reporting compliance rate.¹⁸

On May 20, 2021, the U.S. Treasury published a report entitled "The American Families Plan Tax

FIGURE 3. RELATIONSHIP BETWEEN UNPAID INDIVIDUAL INCOME TAXES AND THIRD-PARTY DATA



Source: Internal Revenue Service.

Compliance Agenda.” The 22-page report reiterated a focus on increasing tax compliance, including increasing third-party reporting and increasing the IRS budget to help narrow the tax gap.¹⁹ One controversial proposal focused on financial institutions reporting additional data to the IRS regarding its customers’ financial accounts on already existing information returns, such as the Form 1099-INT, that would provide the IRS with specifics as to gross inflows and outflows on all business and personal accounts from financial institutions, including bank, loan, and investment accounts but carve out exceptions for accounts below a low *de minimis* gross flow threshold. Another proposal was to expand tax compliance to cover cryptocurrency reporting requirements for investors, cryptocurrency exchanges, and payment service accounts that accept cryptocurrencies and requiring businesses that receive cryptocurrency with a fair market value of more than \$10,000 to report these transactions.

On August 11, 2021, the U.S. Senate voted to approve a \$3.5 trillion budget plan, which included tax reporting provisions for cryptocurrency that would make it easier for the IRS to collect information from those trading in

digital assets by requiring a return for certain transfers of digital assets not otherwise subject to reporting. For high-income non-filers who may be hiding out in the dark web, it may become a lot easier to find crypto transactions in the future.

Conclusion

As the IRS’s attention has increasingly focused on closing the tax gap, the reality for all non-filers, but especially for those who are classified as high-income non-filers, is that it is not a simple game of hiding to see if the IRS can find you before time runs out. And, for non-filers, in the game of “come find me,” the IRS has an ace up its sleeve, *e.g.*, the statute of limitations to audit those tax years remains open forever.²⁰

The odds of not being found are continually decreasing as the IRS obtains more information and possibly more manpower. For those high-income non-filers, unless they voluntarily comply, they may be facing more than delinquent filing and payment obligations: they may also face criminal prosecution. Unlike *Waldo*, most people don’t look good in stripes.

ENDNOTES

* Mr. Horwitz is a former Chair of the Taxation Section, California Lawyers’ Association, a Fellow of the American College of Tax Counsel, a former Assistant U.S. Attorney, Tax Division of the Office of the U.S. Attorney (C.D. Cal), and a former Trial Attorney, U.S. Department of Justice Tax Division. Prior to joining the firm, Ms. Brown served as the Acting U.S. Attorney, the First Assistant U.S. Attorney, and the Chief of the Tax Division of the Office of the U.S. Attorney (C.D. Cal). Ms. Brown obtained her LL.M. in Taxation from the University of Denver, is a Fellow of the American College of Tax Counsel, and was named one of the 2021 Top Women Lawyers in California by the DAILY JOURNAL.

¹ Former IRS Commissioner of the Small Business/Self-Employed Division, Eric Hylton: available online at www.irs.gov/about-irs/how-the-irs-prioritizes-compliance-work-on-high-income-non-filers-through-national-and-international-efforts.

² See www.treasury.gov/tigta/auditreports/2020reports/202030015fr.pdf.

³ See www.gao.gov/assets/gao-19-176.pdf.

⁴ Trademark by Dreamworks Distribution Limited.

⁵ Congressional Research Services, *Federal Tax Gap: Size, Contributing Factors, and the Debate over Reducing It*, August 2, 2021, available online at <https://crsreports.congress.gov/product/pdf/IF/IF11887>.

⁶ *Id.*

⁷ IRM 5.19.2.8.

⁸ See www.cbo.gov/publication/56467.

⁹ January 26, 2021 public statement by Darren Guillot, then-deputy commissioner for collection and operations support, IRS SB/SE. USC Gould School of Law.

¹⁰ See www.irs.gov/pub/irs-pdf/p5409.pdf.

¹¹ See www.irs.gov/about-irs/how-the-irs-prioritizes-compliance-work-on-high-income-non-filers-through-national-and-international-efforts.

¹² *Id.*

¹³ See www.irs.gov/newsroom/irs-increasing-focus-on-taxpayers-who-have-not-filed-tax-return.

¹⁴ *Id.*

¹⁵ See www.irs.gov/newsroom/irs-unveils-new-people-first-initiative-covid-19-effort-temporarily-adjusts-suspends-key-compliance-program.

¹⁶ See www.irs.gov/about-irs/how-the-irs-prioritizes-compliance-work-on-high-income-non-filers-through-national-and-international-efforts.

¹⁷ See www.cbo.gov/publication/56467.

¹⁸ GAO, *Multiple Strategies Are Needed to Reduce Noncompliance: Statement of James R. McTigue, Jr. Director, Strategic Issues*, 2019. Dina Pomeranz, *No Taxation Without Information: Deterrence and Self-Enforcement in the Value Added Tax*, 15 AM. ECON. REV. (2015).

¹⁹ See <https://home.treasury.gov/news/press-releases/jy0188>.

²⁰ Code Sec. 6501(c)(3) states: “In the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.”

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