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ISSUE BRIEF

New IRS Reporting Requirements for Financial Institutions

NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS | **NAFCU.ORG**

BACKGROUND

Earlier this year, the Administration and the Treasury Department released a plan in the Fiscal Year (FY) 2022 budget proposal to help close the tax gap and finance an increase in government spending. According to the initial proposal, financial institutions, including credit unions, would be required to file annual information returns to the IRS on the aggregate inflows and outflows of all business and personal accounts totaling over $600 in a given year.

While initially promoted as a way to close the tax gap by targeting wealthy tax evaders, the proposal's scope would include almost every American with an account at a financial institution. The goal of closing the tax gap is laudable, but there are many questions about the effectiveness of this provision. The proposal also raises grave privacy concerns for account holders at all financial institutions, as well as real data security concerns at the IRS which, if this were enacted, would house the largest database of financial transactions in the world.

This intrusive reporting requirement, and the data security and privacy risks it entails, could help drive Americans out of the financial system and deter others from opening accounts. According to the FDIC's research, more than one third of unbanked Americans cite distrust of financial institutions as a reason for not having an account and requiring institutions to report more of their financial activity to the IRS would likely not help bring them into the system. Credit unions need to be able to assure members and prospective members alike that the financial services they provide are secure and that individuals' financial data and privacy will not be put at risk by the IRS.

Additionally, instituting these requirements would require credit unions and other financial institutions to completely revamp and overhaul their internal reporting structures, which would be cumbersome and costly even without future expansions of the reporting regime. Modifications to this proposal, such as increasing the threshold or exempting certain activities, do not alleviate these concerns. An increase in the reporting threshold would still require credit unions to assess all accounts for potential applicability, and adding exemptions for some transactions, such as paycheck deposits and rent or mortgage payments, would only increase the burden on credit unions as they would be required to identify and exclude those activities before aggregating the remaining annual flows.

Credit unions already report a robust amount of information to the government on accounts. There has not been a detailed cost-benefit analysis to assess the impacts of this proposal. It is unclear if the collection of more data, rather than the more effective use of current data and increasing staff levels to expedite audits of suspicious returns, would better increase tax compliance. Additionally, protecting account holder data and privacy related concerns should be top of mind for lawmakers as these new requirements would provide the IRS with more of Americans' financial data as the agency faces serious challenges in combating identity theft and securing tax information.

LEGISLATIVE DEVELOPMENTS

Both the House and Senate included language to allow this proposal in the FY 2022 Budget Resolution and it is still a candidate for inclusion in the *Build Back Better Act* budget reconciliation package. Currently, lawmakers are considering a threshold of $10,000 in annual flows but with exemptions for deposits from payroll processors and an equivalent amount of annual outflow. This would require credit unions to identify wage or salary payments in a member's account and then apply an account-specific outflow exemption equal to total annual wage or salary income. This modified proposal, in addition to creating compliance challenges and costs, would still likely capture many everyday working Americans.

OUTLOOK AND ASK

With the issue kept alive in the FY 2022 Budget Resolution the threat has not passed, and proposed exemptions would make compliance with the requirement more difficult and costly, while still impacting the majority of consumers. We urge lawmakers to reject any legislative effort to place new IRS reporting requirements on credit unions, at any threshold and regardless of any exemptions. While NAFCU supports efforts to close the tax gap and increase tax compliance, creating additional burdens and costs on credit unions, and placing the financial privacy of more than 127 million credit union members at risk is not the way to go. We urge Congress to explore other avenues to increase tax compliance.