



Highlights of [GAO-07-391T](#), a testimony to the Committee on the Budget, U.S. Senate

## Why GAO Did This Study

The tax gap—the difference between the tax amounts taxpayers pay voluntarily and on time and what they should pay under the law—has been a long-standing problem in spite of many efforts to reduce it. Most recently, the Internal Revenue Service (IRS) estimated a gross tax gap for tax year 2001 of \$345 billion and estimated it would recover \$55 billion of this gap, resulting in a net tax gap of \$290 billion. When some taxpayers fail to comply, the burden of funding the nation's commitments falls more heavily on compliant taxpayers. Reducing the tax gap would help improve the nation's fiscal stability. For example, each 1 percent reduction in the net tax gap would likely yield \$3 billion annually.

GAO was asked to discuss the tax gap and various approaches to reduce it. This testimony discusses the need for taking multiple approaches and to what extent the tax gap could be reduced through three overall approaches—simplifying or reforming the tax system, providing IRS with additional enforcement tools, and devoting additional resources to enforcement. This statement is based on prior GAO work.

## What GAO Recommends

GAO is not making any new recommendations but highlights areas for possible attention.

[www.gao.gov/cgi-bin/getrpt?GAO-07-391T](http://www.gao.gov/cgi-bin/getrpt?GAO-07-391T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or [brostekm@gao.gov](mailto:brostekm@gao.gov).

## TAX COMPLIANCE

# Multiple Approaches Are Needed to Reduce the Tax Gap

## What GAO Found

Multiple approaches are needed to reduce the tax gap. No single approach is likely to fully and cost-effectively address noncompliance since, for example, it has multiple causes and spans different types of taxes and taxpayers. Simplifying or reforming the tax code, providing IRS more enforcement tools, and devoting additional resources to enforcement are three major approaches, but providing quality services to taxpayers also is a necessary foundation for voluntary compliance. Such steps as periodically measuring noncompliance and its causes, setting tax gap reduction goals, evaluating the results of any initiatives to reduce the tax gap, optimizing the allocation of IRS's resources, and leveraging technology to enhance IRS's efficiency would also contribute to tax gap reduction.

Simplifying the tax code or fundamental tax reform has the potential to reduce the tax gap by billions of dollars. IRS has estimated that errors in claiming tax credits and deductions for tax year 2001 contributed \$32 billion to the tax gap. Thus, considerable potential exists. However, these provisions serve purposes Congress has judged to be important and eliminating or consolidating them could be complicated. Fundamental tax reform would most likely result in a smaller tax gap if the new system has few, if any, exceptions (e.g., few tax preferences) and taxable transactions are transparent to tax administrators. These characteristics are difficult to achieve, and any tax system could be subject to noncompliance.

Withholding and information reporting are particularly powerful tools to reduce the tax gap. They could help reduce the tax gap by billions of dollars, especially if they make underreported income transparent to IRS. These tools have led to high, sustained levels of taxpayer compliance and improved IRS resource allocation by helping IRS identify and prioritize its contacts with noncompliant taxpayers. As GAO previously suggested, reporting the cost, or basis, of securities sales is one option to improve taxpayers' compliance. However, designing additional withholding and information reporting requirements may be challenging given that many types of income are already subject to reporting, underreporting exists in many forms, and withholding and reporting requirements impose costs on third parties.

Devoting additional resources to enforcement has the potential to help reduce the tax gap by billions of dollars. However, determining the appropriate level of IRS enforcement resources requires taking into account such factors as how well IRS uses its resources, the proper balance between taxpayer service and enforcement activities, and competing federal funding priorities. If Congress provides IRS more enforcement resources, the amount of tax gap reduction would depend on factors such as the size of budget increases, how IRS manages any additional resources, and the indirect increase in taxpayers' voluntary compliance resulting from expanded enforcement. Increasing IRS's funding would enable it to contact millions of potentially noncompliant taxpayers it identifies but does not contact.