TAX GAP

Multiple Strategies, Better Compliance Data, and Long-term Goals Are Needed to Improve Taxpayer Compliance

GAO Highlights

Highlights of GAO-06-208T, a testimony before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

Long-term budget simulations by GAO and others show that we face large and growing structural deficits due primarily to known demographic trends and rising health care costs. Reducing the annual tax gap—the difference between what taxpayers timely and accurately pay in taxes and what they should pay under the law—could help the nation cope with these long-term fiscal challenges. The tax gap arises through the underreporting of tax liabilities, underpayment of taxes due or "nonfiling" of required tax returns.

This testimony discusses the findings of GAO's recent tax gap report. It addresses the significance of reducing the tax gap, measuring the extent of the tax gap, collecting data on reasons why noncompliance occurs, and the Internal Revenue Service's (IRS) strategies for reducing the tax gap.

What GAO Recommends

GAO's July 2005 report recommended that IRS develop plans to periodically measure tax compliance; take steps to improve its data on the reasons why taxpayers do not comply; and establish long-term quantitative goals on voluntary compliance levels, starting with individual income tax underreporting and total tax underpayment.

In commenting on a draft of the report, IRS agreed with GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-06-208T.

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.

What GAO Found

IRS's recent estimate of the tax gap in 2001 ranged from $312 billion to $353 billion. IRS estimates it will eventually recover some of this tax gap, resulting in a net tax gap of $257 billion to $298 billion. Reducing the tax gap will be challenging given persistent levels of noncompliance. Still, given its size, even small or moderate reductions in the net tax gap could yield substantial returns, which could improve the government's fiscal position. For example, based on IRS's most recent estimate, each 1 percent reduction in the net tax gap would likely yield more than $2.5 billion annually. Thus, a 10 percent to 20 percent reduction of the net tax gap would translate into from $25 billion to $50 billion or more in additional revenue annually.

The tax gap must be attacked on multiple fronts and with multiple strategies over a sustained period of time. These strategies could include simplifying the tax code, providing quality service to taxpayers, and enhancing enforcement of tax laws by using tools such as tax withholding and information reporting.

Regularly measuring compliance is also critical to IRS's ability to reduce the tax gap. A significant part of IRS's tax gap estimate is based on recently collected data on individual income tax reporting compliance. However, other areas of the tax gap rely on old data and outdated methodologies. IRS does not have approved plans, with one exception, to collect more current compliance data covering the various components of the tax gap.

Although it can be challenging to develop, data on the reasons why taxpayers do not comply with the tax laws could help IRS more effectively tailor its efforts to reduce noncompliance. IRS has begun to capture data on the reasons for noncompliance, but it has concerns with the data. Although IRS is developing a system intended to capture better examination data, it does not have specific plans to develop better data on the reasons for noncompliance.

IRS's strategies for reducing the tax gap involve improving taxpayer service and enforcing tax laws, but do not have a clear focus on quantitative long-term goals or results measurement. Establishing clear goals and measuring progress toward them would be consistent with results-oriented management principles and would provide IRS with a solid base upon which to develop a more strategic approach to reducing the tax gap.