

How Can the Federal Government Reduce the Tax Gap?

HIGHLIGHTS FROM GAO-18-39

What is the tax gap?

The **tax gap** is the difference between how much money taxpayers owe, and how much money they actually pay in taxes.

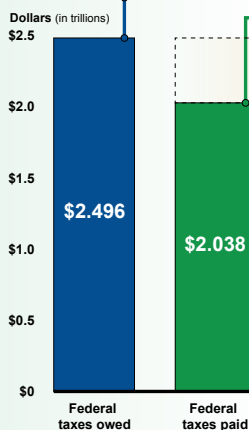
This failure to pay tax dollars adds up to **hundreds of billions per year**, and contributes to the unsustainable growth in federal debt.

For instance, on average during 2008-2010:

Taxpayers owed about **\$2.5 trillion/year** in federal taxes from things like:

- Individual income taxes
- Corporate income taxes
- Employment taxes

However, they actually paid only about **\$2 trillion/year**.



This difference = the **TAX GAP**

And, although IRS estimated that it will collect an extra **\$52 billion/year** through late payments and enforcement activities, it also estimated that **\$406 billion/year will never be collected.**

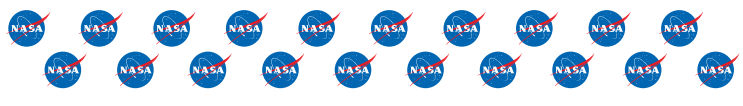
For those years, this **\$406 billion** is more than:

the combined budgets of 10 federal agencies,



or

or 20 times NASA's budget.



Reducing the tax gap could:

Reduce the deficit **without** higher taxes **or** cuts to federal programs

So, why doesn't everyone fully pay their taxes?



Some people make inadvertent mistakes (honest errors).



Others actively try to evade paying them (cheating).

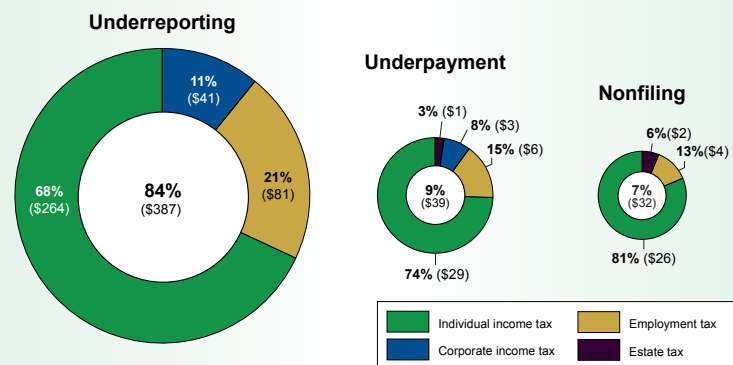
But it is often difficult to tell whether tax errors are intentional or not.

There are three main types of tax noncompliance.

1040	Underreporting	Underpayment	1040 ?	Nonfiling
1040	Understating the amount of income you earned on your tax return. For example, waiters not fully reporting their tips as income are underreporting their taxes.	Accurately reporting and filing your tax return on time, but not paying the taxes you owe.	1040 ?	Not filing your tax return on time or at all.

Underreporting accounted for 84% (\$387 billion) of the average annual tax gap for 2008-2010.

Dollars (in billions)



Note: Estate tax underreporting (\$1m) is not shown because it represents less than one-half percent of total underreporting.

Is there a way to eliminate the tax gap?

Maybe not — doing so could involve more intrusive recordkeeping or reporting than the public is comfortable with, or more resources than IRS can commit.

But, since even modest reductions in the tax gap could yield huge financial benefits to the country, **here are some ideas that could help.**

IRS could:

- Use tax gap and other data to develop a strategy to address noncompliance
- Better use information that whistleblowers provide to find taxpayers who aren't fully paying their taxes
- Provide better customer service (by phone, mail, and online) to help with tax prep

Congress could:

- Require more taxpayers and businesses to file tax returns electronically
- Regulate paid tax return preparers to help improve the accuracy of tax returns
- Make the tax code less complex —so that it is easier for people and businesses to understand and comply with tax laws