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Report to the Joint Committee on Taxation, U.S. Congress

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# REDUCING THE TAX GAP

## Results of a GAO-Sponsored Symposium

GAO/GGD-95-157

# GAO

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**General Government Division**

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The Honorable Bill Archer
Chairman, Joint Committee on Taxation

The Honorable Bob Packwood
Vice-Chairman, Joint Committee on Taxation
United States Congress

As part of our continuing effort to improve the administration of the nation's tax laws, we have been examining the overall issue of taxpayer compliance. Available Internal Revenue Service (IRS) data indicate that taxpayers do not pay (either voluntarily or after IRS compliance efforts) about 13 percent of the federal income taxes due on their income from legal sources. Such an estimated shortfall in tax revenue has been a long-standing and seemingly intractable problem.

## Scope and Methodology

To explore innovative and practical means for increasing taxpayer compliance, we sought the views of experts in the field. On January 12, 1995, we sponsored a symposium that brought together well-known tax authorities with congressional, IRS, and GAO staff (see app. I for a listing of the panelists).

The starting point for the symposium panel discussion was our May 1994 overview report, which highlighted the changes that IRS and Congress need to consider given the body of work we had already completed.[1]

This report discusses the key issues raised during the January 1995 GAO symposium. The views expressed by the panelists are not necessarily the views of GAO. Also, the views are those that were voiced at the session, but not every panelist commented on every issue and not all panelists were present for all of the discussions.[2] In developing this report, we provided each panelist the opportunity to comment on its contents and incorporated the views of those who responded in the final product.

## Results in Brief

Analyses of IRS compliance data show that the federal tax system does not ensure uniform compliance among various groups of taxpayers, e.g.,

[1]See Tax Gap: Many Actions Taken, But a Cohesive Compliance Strategy Needed (GAO/GGD-94-123, May 11, 1994).

[2]Seven of the eight panelists were available for the duration of the symposium. Because of scheduled congressional deliberations, Senator Dorgan participated during part of the discussions.

between wage earners and the self-employed. Given such differences and the persistent level of noncompliance as indicated by IRS' statistics, the panelists who participated in GAO's 1995 symposium agreed that major modifications in the current tax system would be required to substantially improve taxpayer compliance with the nation's tax laws.

In general, the panelists identified a number of objectives that, if met, could help to bring about such change: (1) reduce tax law complexity and make results more certain; (2) extend the reach of tax requirements, such as income tax withholding, that promote taxpayer compliance; (3) expand the compliance techniques available to IRS; (4) adjust the focus of IRS' compliance efforts to address more aggressively the largest aspect of noncompliance, i.e., unreported income; (5) improve the utility of IRS' compliance data; and (6) improve IRS' ability to resolve taxpayer compliance problems quickly, before the problems become serious.

But, as the panelists recognized, any change that extends the reach of the tax system also increases the extent to which the tax system intrudes into taxpayers' affairs and needs to be carefully considered. Thus, the bottom-line decision on whether to extend the reach of the tax system to recover additional revenues due the government under current law involves determining the right mix between (1) the acceptable level of compliance for each type of taxpayer and (2) the acceptable level of tax system intrusiveness to promote compliance within each category of taxpayer.

## Noncompliance: A Significant and Long-Standing Problem

The size of the gross tax gap (the difference between what taxpayers owe and what they do not voluntarily pay) has increased significantly from that first estimated by IRS in 1973.[3] But the relative magnitude of the tax gap, when compared with total income taxes due the federal government, has remained comparatively constant over the intervening years. The estimated amount of taxes not voluntarily paid (about $28 billion to $32 billion in 1973 versus $110 billion to $127 billion in 1992) has hovered around 17 percent of total federal income taxes due each year, according to IRS.

[3]IRS' tax gap estimates (an annual series, 1973 through 1992) have been largely developed from the results of periodically scheduled audits of randomly selected tax returns done under IRS' Taxpayer Compliance Measurement Program (TCMP). These TCMP audits of individuals were done for tax years 1973, 1976, 1979, and 1982. For small corporations, the TCMP audits involved tax years 1977 and 1980. Rather than using TCMP audits to measure compliance of large corporations, IRS has used the results of regular examinations. Also, other TCMP audits of individuals for tax years 1985 and 1988 and small corporations for 1987 have been completed, but the results have not yet been fully incorporated into the tax gap estimates.

In addition to receiving voluntary tax payments, IRS collects about 4 percent of total income taxes due the federal government in any particular tax year as a result of its enforcement efforts, according to IRS. Thus, overall compliance (as measured by taxes paid relative to taxes owed) tends to reach about 87 percent for any given tax year. But, because of the time-consuming nature of IRS' enforcement activities and subsequent appeals and litigation, it may take a number of years to reach the 87-percent compliance level.

The largest component of noncompliance known to IRS involves taxpayers who do not report all taxable income on their tax returns. The size and characteristics of this aspect of noncompliance as well as a breakdown of the other major types of noncompliance that represent IRS' $127-billion gross tax gap estimate for 1992 are as follows:

- 24 percent is attributable to sole proprietors (self-employed individuals) who do not report all income subject to taxation;
- 24 percent is attributable to other individuals who do not report all taxable income (excluding wages and salaries subject to withholding);
- 19 percent is attributable to large corporations (i.e., those with assets of $10 million or more) that understate their tax liability;
- 9 percent is attributable to individuals who do not remit all taxes reported due on their returns;
- 8 percent is attributable to individuals who do not file a return;
- 6 percent is attributable to individuals who take excessive deductions;
- 6 percent is attributable to small corporations (i.e., those with assets of less than $10 million) that understate their tax liability; and
- 4 percent is attributable to all other reasons, such as corporations not remitting all taxes reported due on their returns.

Appendix II provides additional data on IRS' tax gap estimates. As the appendix shows, much more is known about the noncompliance attributable to individuals than to corporations or other business entities.

## Improving Taxpayer Compliance: Views of Symposium Panelists

Analyses of the tax gap and other compliance data show the degree to which the current tax system does not ensure uniform compliance. The panelists identified certain tax system features that tend to promote high levels of compliance for some groups and features that tend to predict noncompliance for other groups. Given such relationships, the panelists identified a number of objectives that, if met, could enhance the effectiveness of the existing system in promoting compliance.

## Promoting Tax Law Simplicity and Certainty

As discussed by the panel members, the simpler the tax code and the more certain the results in applying it, the fewer the opportunities for disagreements over the "fine points" of tax law and the greater the likelihood of voluntary compliance. For example, on the basis of audit results for tax year 1992, IRS estimated that large corporations owed about $142 billion in taxes. In contrast, those corporations set their tax liability at about $118 billion. The difference (about $24 billion) is substantial and, in large part, attributable to ambiguity and complexity in tax law.

Our prior work has shown that resolving disputes arising from tax law ambiguities frequently involves rather lengthy appeals and litigation.[4] In some instances, appeals and litigation have delayed the settlement of tax disputes for years. For example, analyses of IRS data indicate that hundreds of tax disputes between IRS and large corporations remain unsettled for 10 or more years, and some as long as 30 years. Using the results of IRS' audits of 1,700 of the nation's largest corporations, we estimated that for each $1 of IRS' proposed audit assessments, IRS ultimately collected about 22 cents as the full amount due to settle the tax liability.[5]

Tax law complexity may stem from a number of different causes. In part, complexity arises from the attempt to treat all taxpayers fairly. For example, IRS has adopted lengthy rules to enforce general concepts embodied in tax law.

- It has 261 pages of regulations clarifying the "arm's-length standard" for valuing intercompany transactions to ensure that multinational corporations doing business in the United States pay their fair share of taxes. In general, the panelists were skeptical that IRS has a good measure of the extent of noncompliance by these corporations. But, some panelists thought that IRS' $2-billion to $3-billion estimate significantly understated the extent to which these corporations have tended to annually underpay their U.S. federal income tax.
- It has 20 factors for determining who should be treated as an employee or as an independent contractor (i.e., a self-employed individual who provides services). IRS compliance data on the nonfarm self-employed indicated that income tax losses amounted to about $34 billion in 1992.

[4]See Tax Administration: Compliance Measures and Audits of Large Corporations Need Improvement (GAO/GGD-94-70, Sept. 1, 1994).

[5]As specified in the report, given the complexity of tax law and administration, GAO does not know what the proper amount of tax assessment or collection should be but believes that it is reasonable to assume that collecting 22 cents per dollar leaves room for improvement either in the audit recommendation process or the appeals process, or both.

The panelists also indicated that other complexities arise from congressional decisions to use the tax code to resolve social problems through tax preferences. Currently, tax preferences not only amount to about $450 billion of forgone annual taxes but also add to tax administration complexity by increasing the volume of transactions or activities that could result in tax noncompliance. These preferences thereby increase the number of transactions that IRS may need to audit or otherwise oversee to ensure compliance.

For example, recent IRS analysis of one tax preference (the Earned Income Tax Credit)[6] showed that 29 percent of returns filed during a 2-week period in January 1994 claimed too large a tax credit.[7] Earlier IRS estimates had indicated that about 42 percent of the taxpayers who claimed the credit in 1988 received too large a credit, and, because of the complexity of the tax law, many who were entitled to the credit did not claim it. Both circumstances required action on the part of IRS.[8]

To help simplify and make tax collection results more certain, the panelists identified a number of specific changes relating to the taxation of corporations that warranted consideration.

- Most panelists favored IRS moving away from the traditional approach for pricing intercompany transactions to determine taxable income of multinational corporations. But their views on solutions differed.

  Some panelists favored replacing the traditional approach with a formulaic one, e.g., allocating multinational corporate income among tax jurisdictions according to the proportion of certain factors, such as the amount of payroll in each jurisdiction. According to these panelists, the formulaic approach is easy to administer and has been successfully adopted by states (e.g., California) to compute corporate income attributable to corporate operations within a state.

  Other panelists, however, believed that the institution of a formulaic approach by one country and not others would lead to double taxation

[6]The Earned Income Credit is a major federal effort to assist the working poor. The estimated $22 billion in tax credits in 1995 are intended to (1) offset the amount of Social Security taxes on low-income workers and (2) encourage low-income workers to seek employment rather than welfare.

[7]See Earned Income Credit: Targeting to the Working Poor (GAO/T-GGD-95-136, April 4, 1995).

[8]See Tax Policy: Earned Income Tax Credit: Design and Administration Could Be Improved (GAO/GGD-93-145, Sept. 24, 1993).

problems. They noted that without international harmonization of tax rules, an attempt by one country to tax business income that a multinational company attributes to operations in another country could lead to taxation of that income by each of the countries involved. Given the views expressed by foreign officials, however, these panelists recognized that international harmonization of tax laws to support a formulaic approach would be unlikely.

Instead, these other panelists favored the negotiated pricing agreement concept that IRS has begun to pursue. Under the advance pricing agreement concept, a taxpayer(s) may ask IRS to approve ahead of time the methodology to be used to arrive at taxable income. The agreements could be based on traditional arm's-length standard practices for pricing intercompany transactions or a more formulaic method of splitting profits, if warranted. Thus, according to these panelists, the agreements could reap the benefits of a formulaic approach while minimizing the possibility of double taxation since the affected parties would be engaged in the negotiated agreements. On the other hand, some panelists objected to this approach because the negotiations could be done in private, i.e., without public oversight.

- Given the difficulties in identifying taxable income of multinational businesses, the panelists recognized that consideration could be given to establishing a minimum tax on businesses. For example, among Latin American countries it is not uncommon for businesses to be taxed on the basis of asset size, and among African countries on the basis of gross turnover. Such tax arrangements avoid the technical and seemingly unadministerable rules associated with computing profits of multinationals on a case-by-case arm's-length basis. Instead, the tax systems presume that the businesses are realizing some economic gains—otherwise, the business activity would not be occurring—and therefore should be subject to some level of taxation.
- Some panelists also suggested that consideration be given to abolishing the corporate income tax. The rationale for such a change was largely based on the (1) relatively small contribution corporate taxes make—about 10 percent—to the overall funding of the federal government, (2) difficulties IRS has in administering the corporate tax provisions as indicated by the significant difference between tax assessments proposed by IRS and the final tax settlements reached with large corporations, and (3) potential adverse consequences that corporate noncompliance rates may have on the willingness of noncorporate taxpayers to voluntarily pay what they owe. On the other hand, some panelists suggested that exempting corporations from federal income tax

might have a more detrimental impact on individual noncompliance than public knowledge of corporate noncompliance rates.

The panelists also noted that, given the extent of noncompliance associated with the use of the 20 factors for classifying individual taxpayers as employees or independent contractors, a tax system change was warranted. The change involves an extension of income tax withholding requirements and is discussed in the following section.

## Extending the Reach of Tax System Requirements Known to Promote Compliance

As the panelists discussed, the greater the visibility of income to IRS, the higher the rate of timely payment of taxes without IRS intervention. For wages earned by individual tax return filers whose salaries are subject to tax withholding (the most visible form of income to IRS), IRS estimates voluntary reporting compliance to be over 99 percent. In comparison, for interest and dividend income earned by individual tax return filers, which for the most part is subject to tax information reporting[9] but not tax-withholding requirements, income-reporting compliance is about 95 percent.

In contrast, for self-employed tax return filers such as independent contractors whose income is neither subject to withholding nor necessarily covered by information-reporting requirements, IRS estimates income-reporting compliance to be about 41 percent. And, for self-employed individuals who have adopted an informal business style[10] and thus are even less likely to have income reported to IRS on information returns, compliance is estimated to be about 13 percent. In addition, for every $3 of reported earnings by these self-employed filers, another $1 of earnings is not reported by self-employed nonfilers of tax returns.

To better promote compliance, the panelists identified a number of specific changes that warranted consideration.

- Most panelists generally favored extending tax-withholding requirements to certain income currently not subject to such requirements, i.e., business

[9]In general, certain third parties (e.g., businesses and banks but not individuals such as homeowners) are required to make annual information filings with IRS to report various payments made to unincorporated individuals, such as payments for services rendered and interest and dividends. The information is also reported to the individuals receiving the payments.

[10]These informal suppliers are individuals (sole proprietors) who provide products or services through informal arrangements that frequently involve cash-related transactions. In this category IRS includes roadside or sidewalk vendors, moonlighting craftsmen or mechanics, and similar operators with informal business styles, including some auto repair shops, beauty shops, and used car dealers.

payments to independent contractors. The panelists noted that extending withholding would not be inconsistent with international practices.

- As part of the withholding discussion, the panelists questioned the existing practice of attempting to resolve the noncompliance of independent contractors by clarifying the definition of "independent contractor." Instead, panelists offered withholding on income as an appropriate alternative. They recognized that factors outside the realm of tax law (e.g., potential liability for judgments under civil law, responsibility for benefits, and flexibility of working arrangements) may cause employers and workers to seek "independent contractor" status and thereby help to explain the vocal, and effective, resistance to IRS reclassification of "independent contractors" to "employees." But, absent withholding, the panelists were skeptical that IRS compliance efforts could effectively reduce the relatively high degree of noncompliance among independent contractors.[11] Accordingly, the panelists tended to favor some withholding on the basis of payments made by business entities rather than on the employment status of the worker.

In general, the panelists tended to support changes that would make income-related information more visible to IRS. This view stems, in part, from IRS' experience over the last 15 years or so. Over that period of time, audit coverage has dropped substantially, yet compliance rates have remained relatively stable. The generally accepted explanation for such seemingly contradictory occurrences is the expansion of information-reporting requirements and the use of that information by IRS.

During the panel discussion, the individual tax return (Form 1040) was identified as a means to enhance information reporting to IRS. For example, a panelist indicated that the tax return could be modified to ask individual taxpayers whether they employed a domestic worker (e.g., provide a name and Social Security number). Panelists indicated that such a change could potentially yield tens of millions of dollars in additional tax revenues annually. Consideration of such a change could also prompt questions about whether tax return reporting could be adopted to help reduce noncompliance attributable to other self-employed individuals who provide services to nonbusiness taxpayers (e.g., self-employed individuals who provide home repair services to households).

Nonetheless, the panelists recognized that any change that would extend the reach of the tax system also would increase the extent to which the tax

[11]For additional discussion of options, see Tax Administration: Approaches for Improving Independent Contractor Compliance (GAO/GGD-92-108, July 23, 1992).

system would intrude into taxpayers' affairs and would need to be carefully considered. On the one hand, the panelists recognized that something less than total compliance has the potential to erode future voluntary compliance. On the other hand, the panelists also recognized that if a system becomes too intrusive and burdensome, it also has the potential to erode future compliance.

Thus, the bottom-line decision on whether to extend the reach of the tax system involves determining the right mix between the acceptable level of noncompliance for each type of taxpayer and the acceptable level of tax system intrusiveness to promote compliance among those taxpayers. For the most part, the panelists did not believe that the optimum balance had yet been reached with respect to tax withholding requirements.

## Expand the Compliance Techniques Available to IRS

As some panelists pointed out, tax collectors in a number of foreign countries have access to information produced in connection with the administration of tax laws other than those applicable to income (e.g., sales and value-added taxes). The nationwide information produced in connection with these other taxes can be used to track potential sources of unreported income.

The United States has no value-added tax, and taxes based on sources other than income are generally administered by state and local governments. Accordingly, making optimum use of information from disparate sources is an enormous challenge. The panelists encouraged IRS to continue to explore ways to share information from the states. Panelists believed the need for such information has become particularly evident as IRS has begun to refocus its enforcement efforts on detecting unreported income.

Also, over the past 10 to 15 years, penalties for noncompliance have been stiffened, but the panelists recognized that little information is available on the efficacy of the changes.

## More Aggressively Focus Compliance Effort on Unreported Income

Given that the bulk of noncompliance that is known to IRS stems from unreported income, particularly by the self-employed, the panelists believed that IRS needed to deal with this issue more directly. IRS traditionally had focused on the validation of information reported on the return (e.g., deductions) and not necessarily on searching for information omitted from the return.

IRS has recently announced the development of an audit approach geared to identifying unreported income. Under this approach, referred to as "economic reality" audits, IRS auditors will use available information to evaluate taxpayers' financial status and compare it with information reported on their returns, i.e., to determine whether the reported income could sustain the apparent expenses. If the preliminary determination is no, then the IRS auditors would begin expanding their search for leads of unreported income (e.g., using third-party data, such as business licenses, building permits, and other information that may be available from other federal, state, and local agencies as well as private firms such as credit bureaus).

As we have previously reported, this audit technique may require more time than simply auditing the tax return, as has been done in the past.[12] However, IRS officials believe that the benefits from identifying more unreported income will more than offset the cost associated with increased audit time.

Most panelists generally supported refocusing IRS audits toward identifying unreported income. But given the early stage of the refocusing, it is too soon to predict what the results will be. As explained in our 1994 report on tax compliance measurement, we believe that finishing IRS auditor training before the audits start and ensuring that auditors appropriately follow the approach will improve the likelihood of achieving the desired benefits.

Also, some panelists were concerned that an expansion of IRS' debt collection role could dilute the focus of IRS from assessing and collecting the appropriate amount of taxes, including taxes due on unreported income. These panelists recognized that IRS already collects some nontax government debts through a program to offset tax refunds. But, they expressed concern over what they saw as indications that IRS may become the collection agent for additional nontax debts. They also questioned the appropriateness of extending IRS' extraordinary tax collection powers to routine business transactions involving the federal government. Accordingly, the panelists generally favored in-depth research of the possible impacts on the tax system before such action is taken.

## Improve IRS' Compliance Data

While the panelists saw the tax gap as a problem serious enough to warrant a change in the tax system, they viewed the present tax gap data

[12]Tax Compliance: Status of the Tax Year 1994 Compliance Measurement Program (GAO/GGD-95-39, Dec. 30, 1994).

as having limited value for planning compliance activities. Further, some panelists believed that the estimates of the tax gap, if left unchanged, had the potential to negatively influence the willingness of the nation's taxpayers to voluntarily comply with federal tax laws. Although taxpayers' continued cooperation is the underpinning to the nation's voluntary tax system, the current tax gap data could mislead some taxpayers into trying to exploit opportunities for paying less than what is owed. These concerns tended to stem from the following issues:

- Much of the data on the tax gap is based on IRS' proposed assessments, not final assessments. Thus the estimates may bear little or no similarity to the gap between voluntary payment and final settlement of the tax liability. For example, the panelists referred to our 1994 report, which indicated that for every $1 of proposed assessments made to very large corporations, only about 22 cents is ultimately determined to be due the federal government and collected by IRS.[13]
- Much of the data is aggregated at such a general level that they provide little useful information for discerning underlying compliance problems warranting IRS attention. For example, little is known about noncompliance trends encapsulated under the umbrella categories such as "large corporation," "sole proprietor," or "informal supplier."
- The data provide a gross estimate of taxpayer noncompliance without considering the permissible limits of intrusiveness imposed on the current system of taxation. Thus, for example, the tax gap estimate includes taxes that are effectively out of IRS reach because of congressionally determined limits on record keeping, withholding, or information-reporting requirements.

The panelists discussed ways in which to improve the tax gap data, such as assigning research responsibility to an agency other than IRS. But after deliberations, the panelists tended to conclude that the estimating methodology needed further study and that IRS' research staff should be amply supported to make such changes. The panelists were also concerned that IRS' tax gap measures do not cover employment taxes. Efforts to measure this tax gap have not, as yet, been completed.

## Improve IRS' Ability to Resolve Compliance Problems Quickly

As the panelists noted, taxpayer compliance is prompted by a wide spectrum of IRS activities, such as tax audits, outreach efforts, and education. The key is for IRS to tailor its efforts to the needs of the situation and to act appropriately and on a timely basis. The longer it takes

[13]See footnotes 4 and 5.

to reach a taxpayer, whether by computer matching, examining records, prosecuting a case, or collecting a tax debt, the less likely that IRS will achieve a favorable outcome.

For example, after much prodding by GAO and Congress to explore the feasibility of using telephone contacts in the tax collection process, IRS tests show that early telephone contact with delinquent taxpayers can yield better results than the cumbersome time-consuming process of mailing a series of notices and letters.[14] IRS is revising its collection process along these lines.

IRS' automated systems, however, were not originally designed to support prompt intervention. They are a patchwork of information systems that are not integrated. They are not capable of readily interchanging information among various systems that support each IRS function (e.g., examination and collection). Moreover, the systems were not designed to provide IRS with detailed information on which to assess compliance problems. They were designed to facilitate the processing of tax returns and the scheduling and managing of IRS compliance efforts.

IRS is currently engaged in a long-term, multibillion-dollar effort to redesign its systems to take advantage of new technology. The panelists recognized that major systems redesign initiatives are needed for IRS to (1) develop detailed information on compliance patterns of taxpayers; and (2) extend its early intervention strategy, e.g., resolve taxpayers' problems on initial contact. They encouraged IRS to finish its computer modernization and related changes to operating systems as soon as possible.

## GAO Observations on the Challenge for the Future

IRS has set an overall goal of achieving 90-percent compliance with the nation's tax laws by 2001. On the surface, reaching this goal would appear to be a modest accomplishment (i.e., reducing the difference between what taxpayers owe but do not pay from about 13 percent to 10 percent over a 7-year period). But, as indicated by the tax gap data developed by IRS over the past 20 years, such a change would constitute a rather significant departure from past experience. By IRS' reckoning in its 3-year operational plan (Business Master Plan), the change would generate about $6.7 billion more tax revenue in 1997 than in 1994.

[14]See Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993); and Tax Administration: Tax Compliance Initiatives and Delinquent Taxes (GAO/T-GGD-95-74, Feb. 1, 1995).

In summary, the near-term revenue gain of $6.7 billion from IRS' planned improvements is modest when compared to current projections of over $100-billion annual tax gaps. Accordingly, absent significant tax system changes, Congress should not expect much additional tax revenues. This report has provided the viewpoints of a number of tax experts on what those changes could entail.

But, as indicated before, any change that would extend the reach of the tax system also would increase the extent to which the tax system would intrude into the public's affairs and would need to be carefully considered. Thus, the bottom-line decision on whether to broaden the reach of the tax system to recover additional revenues due the government under current law would involve determining the right balance between (1) the acceptable level of compliance for each type of taxpayer and (2) the acceptable level of tax system intrusiveness to promote compliance.

We are sending copies of this report to the Senate Finance Committee, House Committee on Ways and Means, Senate Committee on Governmental Affairs, House Committee on Government Reform and Oversight, House and Senate Appropriations Committees, the Commissioner of Internal Revenue, symposium panelists, and other interested parties. We will make copies available to others on request.

This report was prepared under the direction of Natwar M. Gandhi, Associate Director. Other major contributors to this report are listed in appendix III. If you have any questions concerning this report, please contact me at (202) 512-5407.

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# Contents



**Abbreviations**

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|---|---|
| IRS | Internal Revenue Service |
| TCMP | Taxpayer Compliance Measurement Program |

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Note: The panel discussion was moderated by Mr. Natwar M. Gandhi, Associate Director of GAO's Tax Policy and Administration Issue Area. Other GAO participants in the panel discussions are listed in app.III.

# Selective Tax Gap Summary Statistics

**Table II.1: Gross Tax Gap Estimates for Tax Years 1981 and 1992, in Nominal Dollars**

Dollars in millions

| Source of tax gap | 1981 tax gap amount | 1992 tax gap amount | Percent increase |
|---|---|---|---|
| Individual tax gap | $61,900 | $93,994 | 51.8 |
| Unreported income | 40,433 | 62,759 | 55.2 |
| Sole proprietors | 18,714 | 30,173 | 61.2 |
| All other income | 21,719 | 32,586 | 50.0 |
| Overstated deductions[a] | 7,449 | 8,081 | 8.5 |
| Individual nonfiler | 5,231 | 10,233 | 95.6 |
| Individual remittance gap | 8,300 | 11,400 | 37.3 |
| Math errors | 487 | 1,521 | 212.3 |
| Corporate tax gap | 14,066 | 33,135 | 135.6 |
| Small corporations | 4,461 | 6,999 | 56.9 |
| Large corporations | 8,638 | 23,716 | 174.6 |
| Others[b] | 167 | 420 | 151.5 |
| Corporate remittance gap | 800 | 2,000 | 150.0 |
| **Total tax gap[c]** | **$75,966** | **$127,129** | **67.2** |

[a]Includes subtractions for erroneous deductions, exemptions, credits, and other adjustments.

[b]Includes unreported income and overstated deductions for exempt organizations' unrelated business income and for fiduciaries.

[c]As shown in Table II.3, the gross tax gap in 1992 dollars increased from $117 billion in 1981 to $127 billion in 1992—about 8.7 percent.

Sources: Income Tax Compliance Research, IRS Publication 1415 (7-88); and Income Tax Compliance Research: Net Tax Gap and Remittance Gap Estimates, IRS Publication 1415 (4-90).

**Table II.2: Gross Tax Gap Estimates by Source for 1981 and 1992, in Nominal Dollars**

Dollars in millions

| Description | 1981 tax gap amount | 1992 tax gap amount |
| --- | --- | --- |
| Individual tax gap | $61,900 | $93,994 |
| Wages and salaries | 2,378 | 1,919 |
| Interest | 1,969 | 1,891 |
| Dividends | 2,075 | 2,142 |
| State tax refund | 127 | 102 |
| Alimony | 124 | 253 |
| Capital gains | 1,822 | 11,535 |
| IRS Form 4797 | 217 | 1,264 |
| Pensions and annuities | 456 | 144 |
| Taxable unemployment | 107 | 388 |
| Farm income | 2,350 | 1,909 |
| Partnership income | 2,755 | 2,246 |
| Small business corporation | 912 | 729 |
| Estates and trusts | 49 | 73 |
| Rents and royalties | 2,012 | 4,481 |
| Nonfarm sole proprietors | 18,714 | 30,173 |
| Other income | 4,366 | 3,465 |
| Taxable Social Security | 0 | 44 |
| Adjustments to income | 752 | 694 |
| Deductions | 3,540 | 3,889 |
| Exemptions | 1,844 | 2,224 |
| Credits | 1,313 | 1,274 |
| Math errors | 487 | 1,521 |
| Nonfiler | 5,231 | 10,233 |
| Nonremittance | 8,300 | 11,400 |
| Corporate tax gap | 14,066 | 33,135 |
| Small corporations | 4,461 | 6,999 |
| Large corporations | 8,638 | 23,716 |
| Unrelated business income | 56 | 218 |
| Fiduciary | 111 | 202 |
| Nonremittance | 800 | 2,000 |
| **Total tax gap[a]** | **$75,966[b]** | **$127,129** |

[a]Totals may not add due to rounding.

[b]As shown in Table II.3, the 1981 gross tax gap in 1992 dollars was $117 billion.

Source: Income Tax Compliance Research, IRS Publication 1415 (7-88).

**Table II.3: Gross Tax Gap Estimates for Tax Years 1981 and 1992, in 1992 Dollars**

Dollars in millions

| Source of tax gap | 1981 tax gap amount | 1992 tax gap amount | Percent increase |
|---|---|---|---|
| Individual tax gap | $94,851 | $93,994 | -0.9 |
| Unreported income | 61,956 | 62,759 | 1.3 |
| Sole proprietors | 28,676 | 30,173 | 5.2 |
| All other income | 33,280 | 32,586 | -2.1 |
| Overstated deductions[a] | 11,414 | 8,081 | -29.2 |
| Individual nonfiler | 8,016 | 10,233 | 27.7 |
| Individual remittance gap | 12,718 | 11,400 | -10.4 |
| Math errors | 746 | 1,521 | 103.9 |
| Corporate tax gap | 21,552 | 33,135 | 53.7 |
| Small corporations | 6,836 | 6,999 | 2.4 |
| Large corporations | 13,236 | 23,716 | 79.2 |
| Others[b] | 256 | 420 | 64.1 |
| Corporate remittance gap | 1,226 | 2,000 | 63.1 |
| **Total tax gap[c]** | **$116,988** | **$127,129** | **8.7** |

[a]Includes subtractions for erroneous deductions, exemptions, credits, and other adjustments.

[b]Includes unreported income and overstated deductions for exempt organizations' unrelated business income and for fiduciaries.

[c]Totals may not add due to rounding.

Sources: Income Tax Compliance Research, IRS Publication 1415 (7-88); and Income Tax Compliance Research: Net Tax Gap and Remittance Gap Estimates, IRS Research Division, Publication 1415 (4-90).

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