

Reducing the Tax Gap

July, 2021

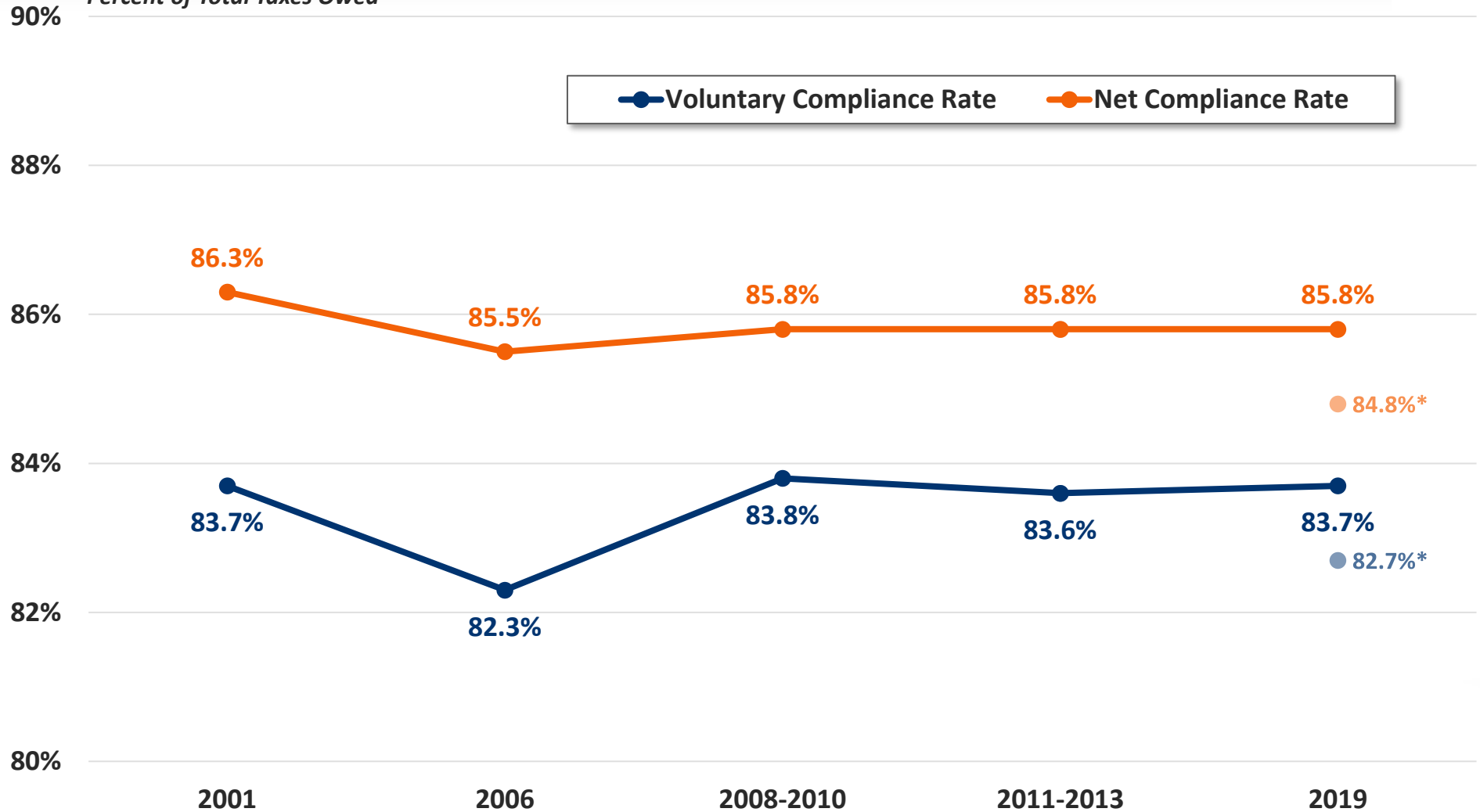


**COMMITTEE FOR A
RESPONSIBLE FEDERAL BUDGET**

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Americans Underpay Their Taxes By About 15%

Percent of Total Taxes Owed



* Treasury adjusted estimates

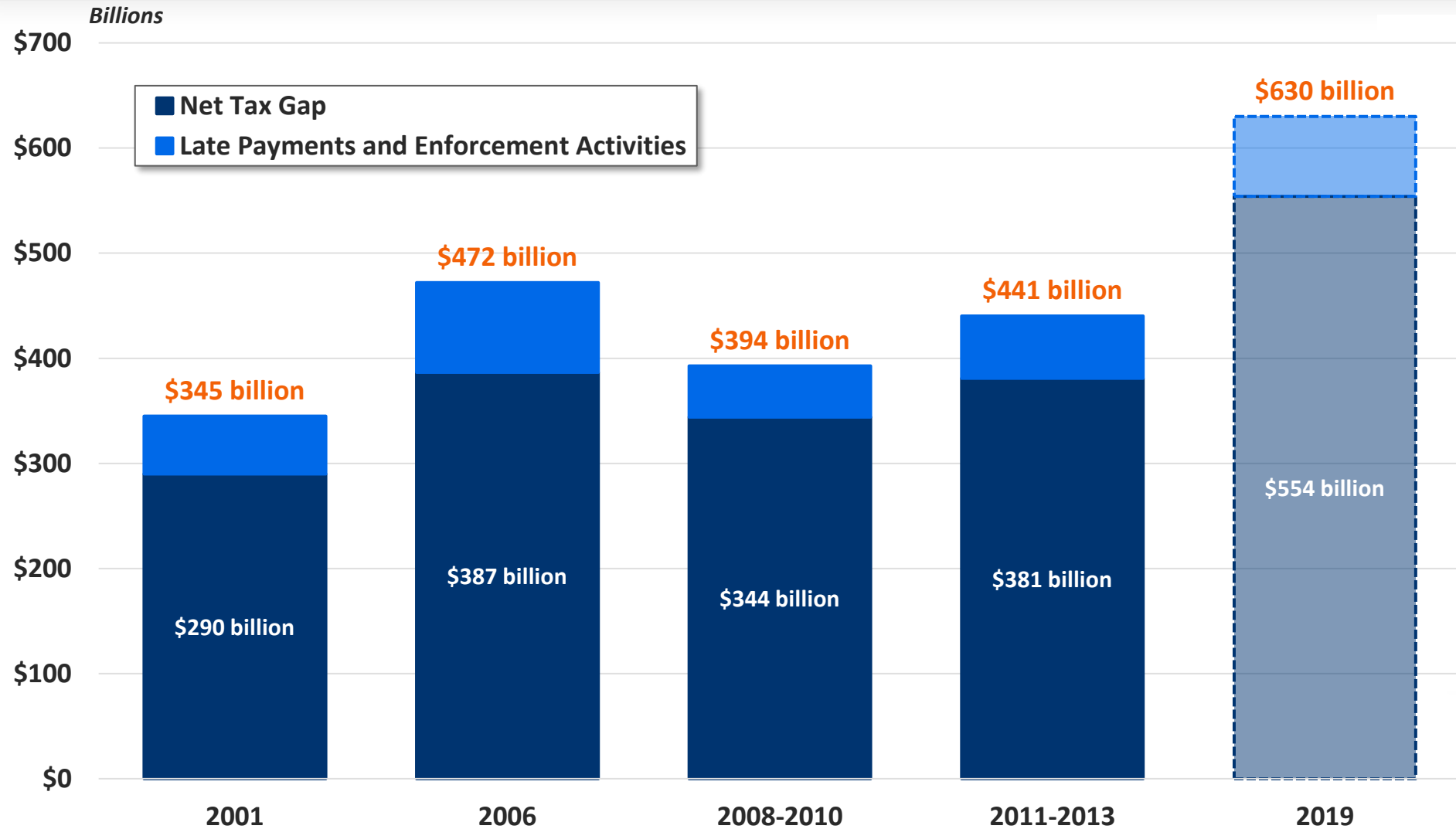
Note: Due to updated methodologies, these estimates are not directly comparable. The estimate for TY 2006 has been revised to reflect methodologies used for the TY 2008-2010 estimate, and the TY 2008-2010 estimate has been revised to reflect methodologies used for the TY 2011-2013 estimate. All estimates for TY 2019 are preliminary.

Source: Internal Revenue Service, Treasury Department.

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There's Half a Trillion in Unpaid Taxes Each Year

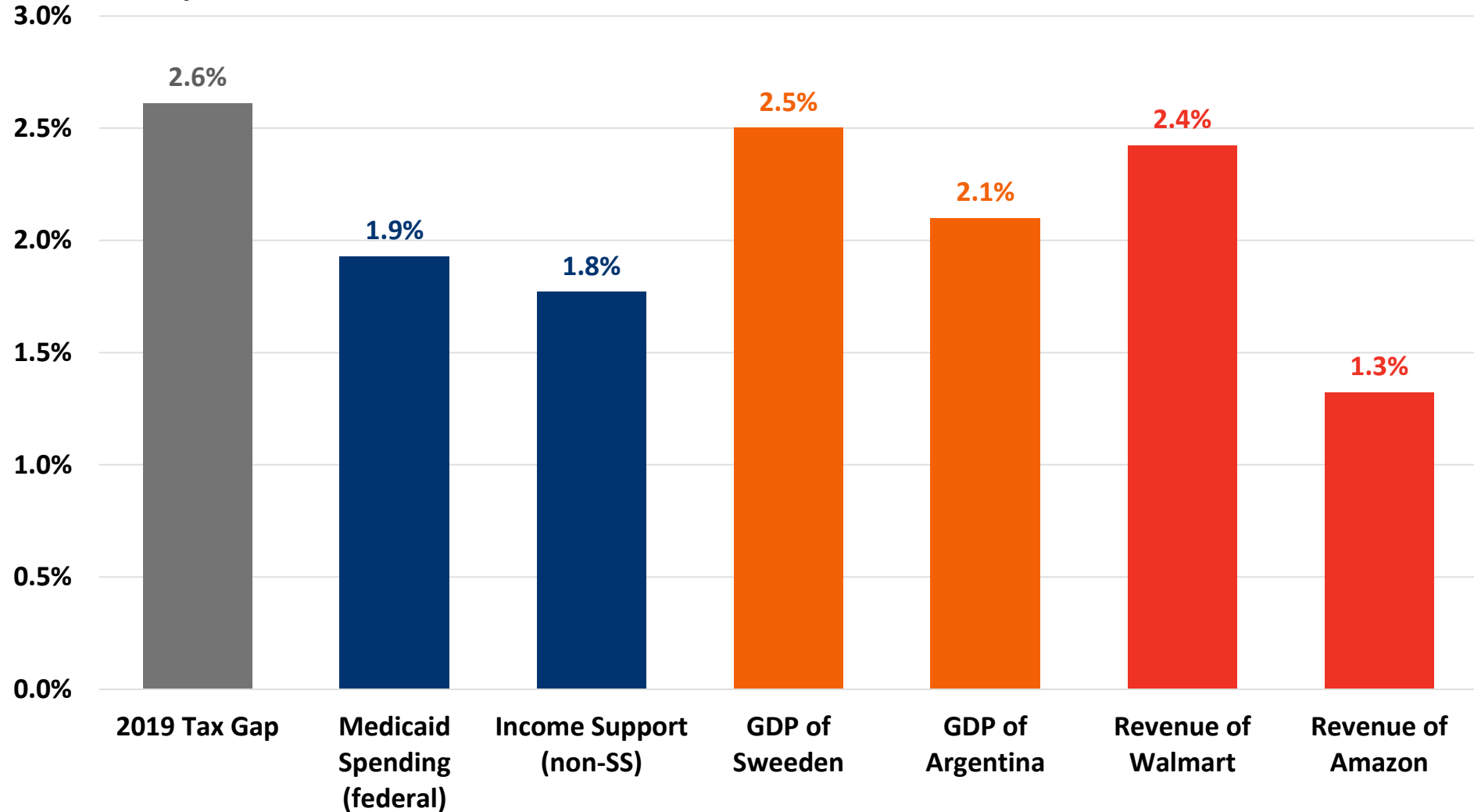


Note: Due to updated methodologies, these estimates are not directly comparable. The estimate for TY 2006 has been revised to reflect methodologies used for the TY 2008-2010 estimate, and the TY 2008-2010 estimate has been revised to reflect methodologies used for the TY 2011-2013 estimate. The TY 2019 estimate, which is preliminary, reflects an even newer methodology.

Source: Internal Revenue Service, Treasury Department.

That's 2.6 Percent of GDP – Which is A Lot of Money

Percent of U.S. GDP

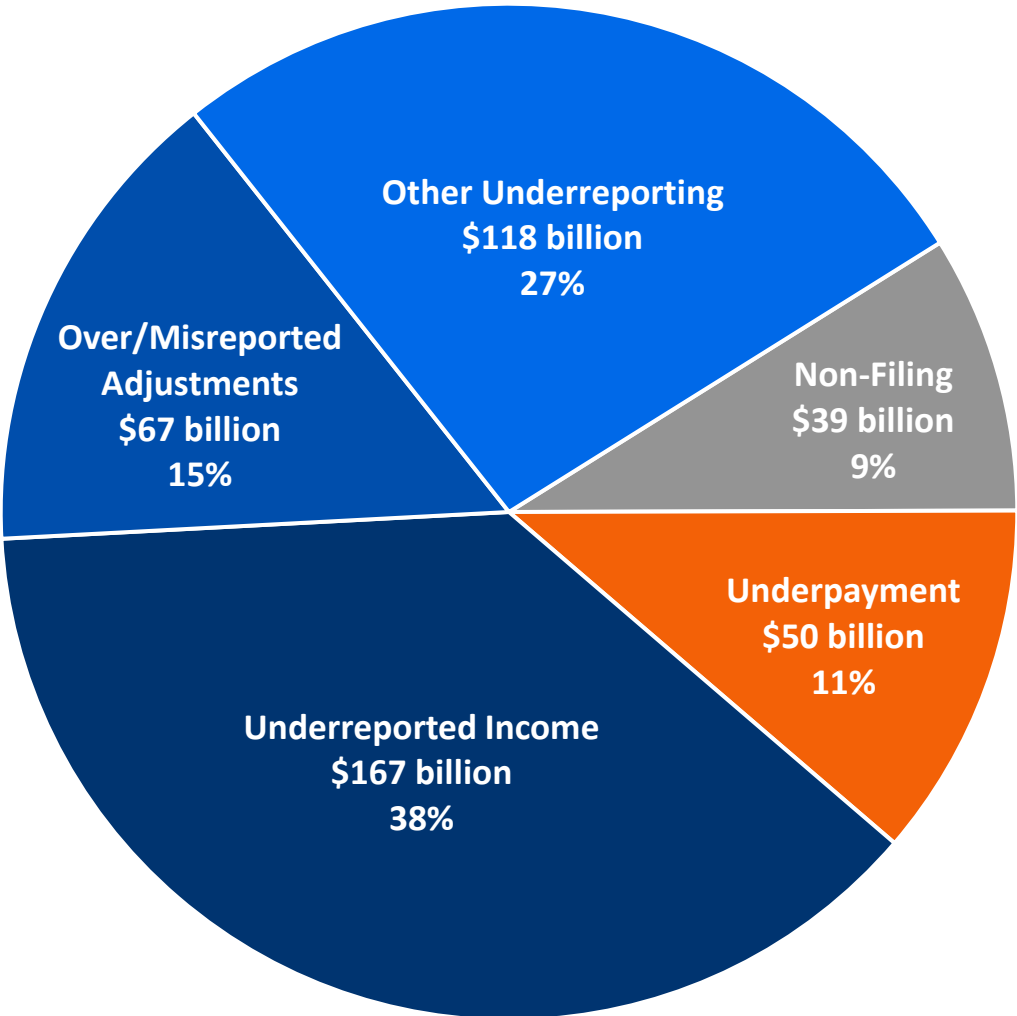


Note: Data reflects 2019 figures

Source: Treasury Department, Congressional Budget Office, World Bank, Wall Street Journal

Most of the Tax Gap is from Underreporting

Percent of Gross Tax Gap



Source: Internal Revenue Service

Note: Data reflects average annual amounts during the Tax Year (TY) 2011 through 2013 period

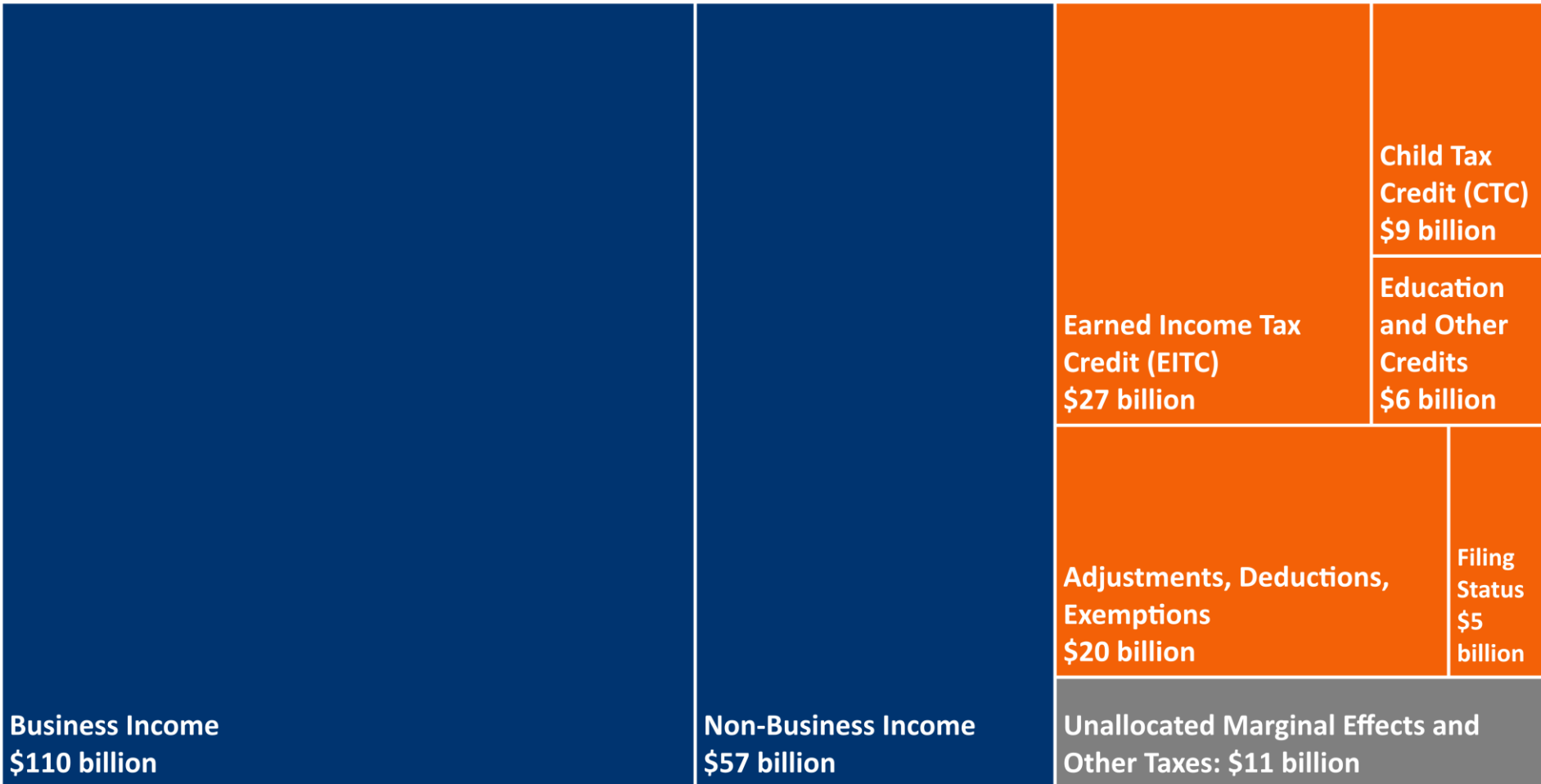


A Breakdown of the Gross Individual Income Tax Gap



■ Nonfiling Gap ■ Underpayment Gap ■ Underreporting Gap

A Breakdown of the Underreporting, Only



- Income Underreporting
- Interactions and Other Effects
- Over- or Misreporting of Various Adjustments

Source: Internal Revenue Service

Note: Data reflects average annual amounts during the Tax Year (TY) 2011 through 2013 period



A Breakdown of the Gross Payroll Tax Gap



■ Nonfiling Gap ■ Underpayment Gap ■ Underreporting Gap

A Breakdown of the Gross Corporate Income Tax Gap



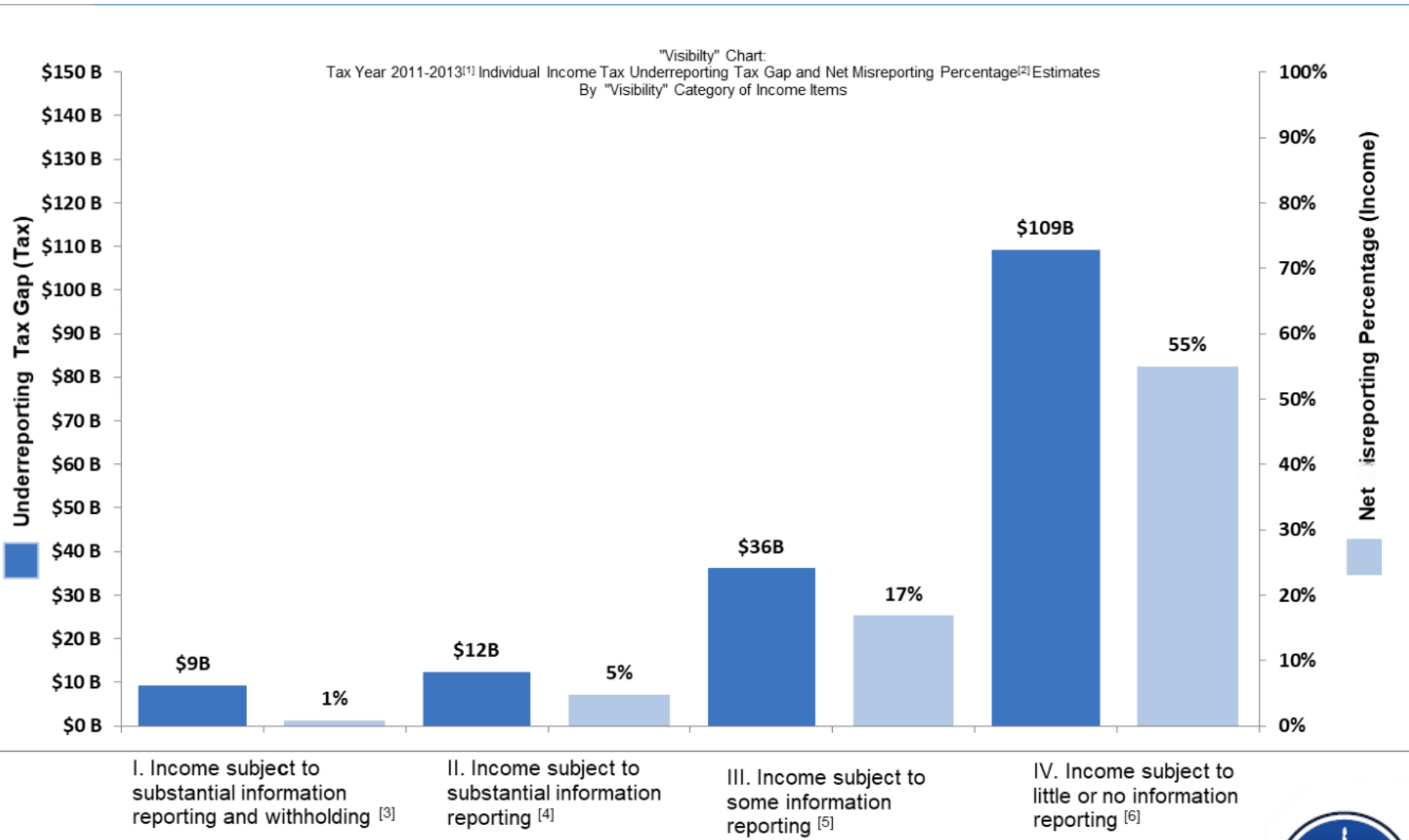
■ Underpayment Gap ■ Underreporting Gap

The Tax Gap is Largely Business Income

Percent of Gross Tax Gap

	Individual Income Tax	Payroll Tax	Corporate and Other Taxes	Total
Business and Self-Employment Income	36%	12%	10%	58%
Labor and Other Income	12%	6%	-	18%
Credits, Deductions, and Adjustments	15%	-	-	15%
Capital Income	8%	-	<1%	9%
Total	71%	18%	11%	

Which Has Little Information Reporting



Source: Internal Revenue Service, "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013", September 2019
 Note: Data in chart covers Tax Years 2011-2013



Which Has Little Information Reporting

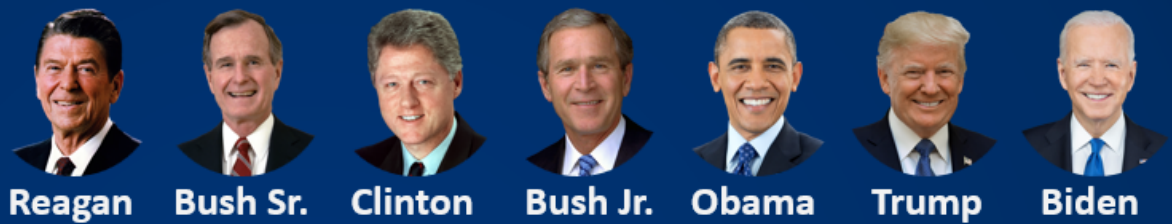
Tax Return Line Items	Tax			Line Item Amount
	Tax Gap	Share of Gross Tax Gap	Share of Individual Income Tax Underreporting Tax Gap	Net Misreporting Percentage ^[2]
Gross Tax Gap	\$441	100%	n.a.	n.a.
Individual Income Tax Underreporting Tax Gap	\$245	56%	100%	18%
Items Subject to Substantial Information Reporting and Withholding	\$9	2%	4%	1%
Wages, salaries, tips	\$9	2%	4%	1%
Items Subject to Substantial Information Reporting	\$12	3%	5%	5%
Interest income	[3]	[3]	[3]	1%
Dividend income	\$1	[3]	1%	5%
State income tax refunds	\$1	[3]	[3]	12%
Pensions & annuities	\$5	1%	2%	3%
Unemployment Compensation	[3]	[3]	[3]	7%
Taxable Social Security benefits	\$4	1%	2%	11%
Items Subject to Some Information Reporting	\$36	8%	15%	17%
Partnership, S-Corp, Estate & Trust, etc.	\$19	4%	8%	11%
Alimony income	[4]	[4]	[4]	[4]
Capital gains ^[5]	\$17	4%	7%	23%
Short-term Capital Gains	\$7	2%	3%	24%
Long-term Capital Gains	\$10	2%	4%	15%
Items Subject to Little or No Information Reporting	\$109	25%	45%	55%
Form 4797 income	\$2	1%	1%	36%
Other income	\$16	4%	6%	42%
Nonfarm proprietor income	\$68	15%	28%	56%
Farm income	\$6	1%	2%	62%
Rents & royalties	\$17	4%	7%	51%
Other Taxes	\$1	[3]	1%	3%
Unallocated Marginal Effects	\$10	2%	4%	n.a.
Income Offsets (Adjustments, Deductions, Exemptions)	\$20	4%	8%	5%
Total Credits	\$42	10%	17%	38%
Filing Status	\$5	1%	2%	n.a.

Source: Internal Revenue Service, "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013", September 2019

Note: Table covers Tax Years 2011-2013



Closing the Tax Gap is a Bipartisan Priority



	Reagan	Bush Sr.	Clinton	Bush Jr.	Obama	Trump	Biden
IRS Funding	✓	✓	✓	✓	✓	✓	✓
Information Reporting	*	*	✓	✓	✓	*	✓
Penalties and Oversight	✓		✓	✓	✓	✓	✓
Other Tax Gap Measures	✓	✓	✓	✓	✓	✓	✓
Reducing the Tax Gap	✓	✓	✓	✓	✓	✓	✓

* Supported modest information reporting enhancements as a component of another policy

Note: Table includes policies proposed in one or more President's Budgets

Closing the Tax Gap is a Bipartisan Priority

Ronald Reagan

IRS revenue initiative.—In 1987 the Internal Revenue Service will begin the initial phase of an initiative to close the gap between taxes owed and paid, and to improve overall compliance with the tax laws. Based on a Grace Commission recommendation, examination staffing will be increased by 2,500 full-time equivalent personnel in each year, 1987–89. Advance hiring of about 330 full-time equivalent personnel will begin in 1986. Receipts are estimated to increase by \$0.6 billion in 1987, \$1.5 billion in 1988, and \$2.6 billion in 1989 as a result of this initiative.

IRS automated examination system.—Beginning in 1987, the productivity of IRS auditors will be increased significantly when they are equipped with portable computers that will enable them to audit tax returns more promptly and efficiently. Additional productivity gains and reductions in support staff will be realized in later

George H.W. Bush

Internal Revenue Service (IRS) Initiatives

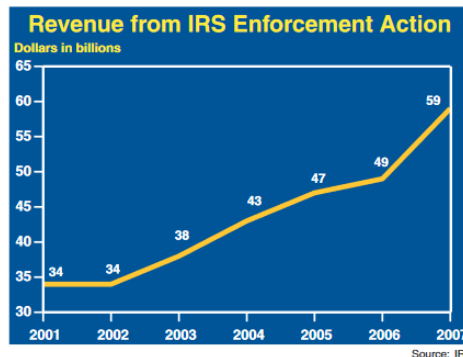
Increase IRS enforcement funding and initiate management reforms.—To close the gap between taxes owed and taxes paid, additional funding is provided to IRS. These funds are to be used to collect delinquent tax debt, enhance tax document matching to detect underreporting of income and improper dependent claims, audit mortgage interest deductions, and increase the audit workforce. In addition, improvements in the management of tax law enforcement resources will increase revenue yields without requiring additional expenditures. These initiatives are expected to increase receipts \$10.2 billion over the 1991–1995 period.

George W. Bush

- **Collects revenues through law enforcement initiatives.** \$7.5 billion is provided for enforcement in 2009, an increase of 7 percent over 2008, including new initiatives with an expected return on investment of \$6.5 to \$1 once fully implemented.

- New enforcement initiatives will improve revenue reporting of small businesses and the self-employed—estimated to be the largest component of the tax gap, increase reporting compliance of domestic taxpayers with offshore financial transactions, and increase audits of large corporations.

- In 2007, the IRS collected \$2.7 trillion in Federal tax revenue, with a record \$59 billion collected through enforcement activities, an increase of 20 percent over 2006. This represents a return on investment for enforcement-related activities of \$8.6 to \$1.



Donald Trump

Invests in a 21st Century Internal Revenue Service (IRS). The IRS collects approximately \$3.5 trillion in tax revenue annually and processes more than 253 million tax returns and forms resulting in more than \$464 billion in tax refunds. The Budget proposes \$11.5 billion in base funding for IRS to ensure that IRS can fulfill its core tax filing season responsibilities, continue critical IT modernization efforts, and provide acceptable levels of taxpayer service.

The Budget provides \$290 million for the IRS's multiyear IT modernization efforts, including upgrading its antiquated infrastructure and integrating its multiple case management and tax processing systems. Approximately 90 percent of individual taxpayers file their taxes electronically and can check on the status of their funds electronically. However, for most other taxpayer interactions, taxpayers and the IRS must interact through the mail, which slows the resolution of issues. These funds would also be used to increase taxpayers' ability to interact with IRS securely and electronically, improving the time it takes for IRS to resolve concerns.

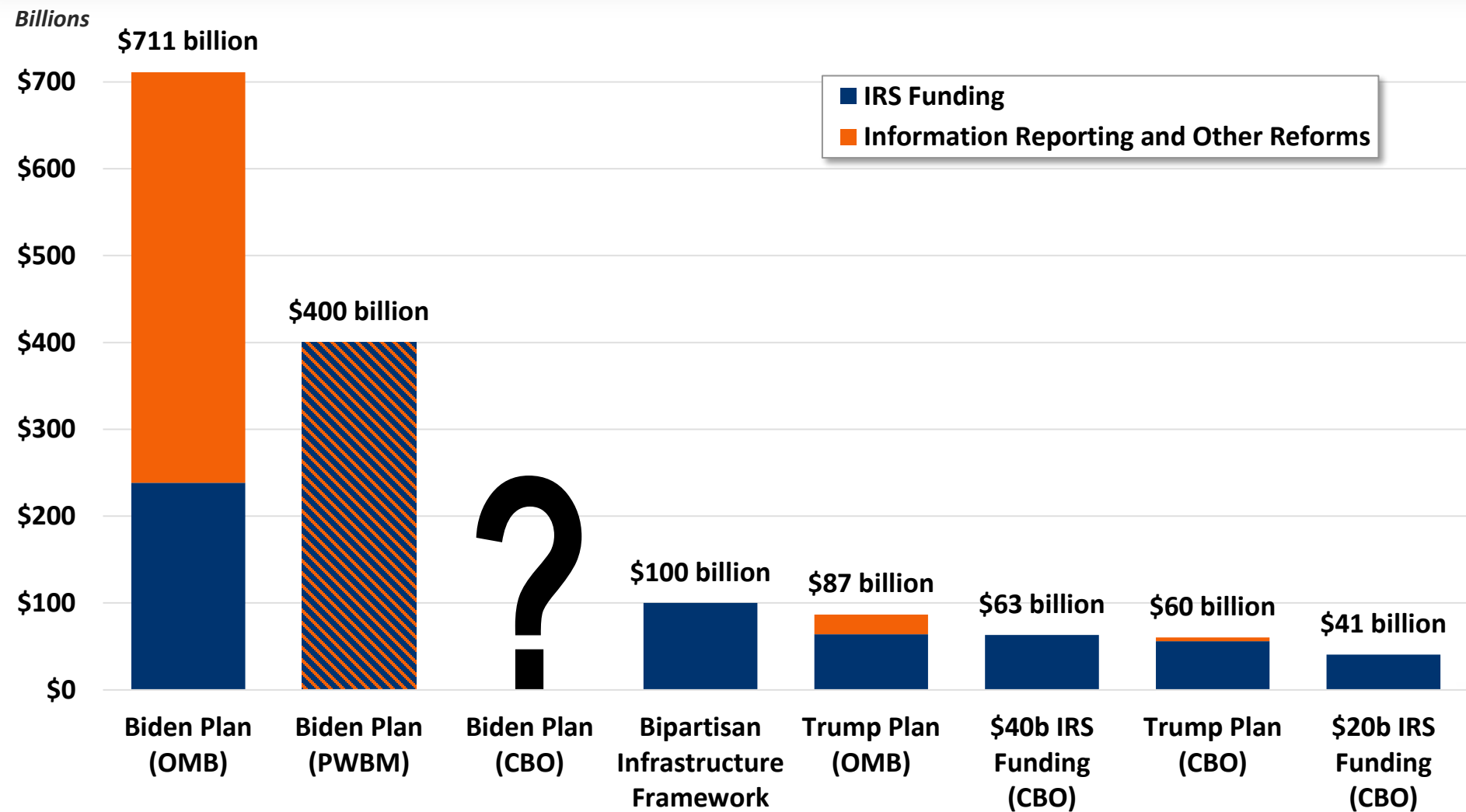
The Budget also proposes legislation enabling additional funding for new and continuing investments to expand and strengthen tax enforcement. These additional proposed investments are estimated to generate approximately \$47 billion in additional revenue at a cost of \$15 billion, yielding a net savings of \$33 billion over 10 years. The Budget also includes several proposals to ensure that taxpayers comply with their obligations and that tax refunds are only paid to those who are eligible, including: improving oversight of paid tax preparers; giving IRS the authority to correct more errors on tax returns before refunds are issued; requiring a valid Social Security Number for work in order to claim certain tax credits; and increasing wage and information reporting.

How Can We Reduce the Tax Gap?

- Provide for stable tax enforcement funding.
- Fund and empower the IRS to make better use of data analytics, improve taxpayer services, and prevent and correct errors.
- Enhance information reporting, withholding, and electronic filing.
- Increase penalties, incentives, and education to improve timely and accurate tax compliance.
- Demand accountability from tax preparers and accountants.
- Coordinate with other countries on tax and income reporting.
- Establish new rules and procedures for gig work, crypto-currency, and other areas with high underreported income.
- Close loopholes that undermine compliance.



Net Savings from Various Tax Gap Proposals



Source: Congressional Budget Office, Office of Management and Budget, Penn Wharton Budget Model

Returns on IRS Funding, According to Treasury

Return on Investing in the IRS (inflation adjusted)

\$M	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total	Return Per Dollar Invested
Mandatory												
Cost	1,142	2,095	3,035	4,174	5,563	7,189	9,203	11,405	14,115	14,546	72,467	
FTE	2,642	6,729	13,326	20,874	29,783	39,803	51,770	64,770	80,349	81,743		
Direct Revenue	-	631	3,098	6,959	12,435	19,758	29,903	40,730	53,721	63,780	231,015	3.2
Revenue Protected	-	-	214	603	1,402	2,584	4,178	6,211	8,532	11,157	34,881	
Direct & Protected Revenue	-	631	3,312	7,562	13,837	22,342	34,081	46,941	62,253	74,937	265,896	3.7
Program Integrity Cap Adjustment												
Cost	417	647	643	660	677	694	712	731	750	769	6,700	
FTE	2,555	5,109	5,109	5,109	5,109	5,109	5,109	5,109	5,109	5,109		
Direct Revenue	334	1,690	2,826	3,538	4,099	4,565	4,954	5,279	5,554	5,794	38,633	5.8
Revenue Protected	-	168	339	517	795	1,324	1,641	1,964	2,242	2,657	11,647	
Direct & Protected Revenue	334	1,858	3,165	4,055	4,894	5,889	6,595	7,243	7,796	8,451	50,280	7.5
Mandatory and Cap Adjustment Combined												
Cost	1,559	2,742	3,678	4,834	6,240	7,883	9,915	12,136	14,865	15,315	79,167	
FTE	5,197	11,838	18,435	25,983	34,892	44,912	56,879	69,879	85,458	86,852		
Direct Revenue	334	2,321	5,924	10,497	16,534	24,323	34,857	46,009	59,275	69,574	269,648	3.4
Revenue Protected	-	168	553	1,120	2,197	3,908	5,819	8,175	10,774	13,814	46,528	
Direct & Protected Revenue	334	2,489	6,477	11,617	18,731	28,231	40,676	54,184	70,049	83,388	316,176	4.0

Returns on IRS Funding, According to CBO

Estimated Effects of Two Options to Increase Appropriations for the Internal Revenue Service

Billions of Dollars

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	Total, 2021– 2030
Option 1: Increase Appropriations by \$20 Billion											
Change in Outlays	0.5	1.0	1.5	2.0	2.5	2.5	2.5	2.5	2.5	2.5	20.0
Change in Revenues	0.3	1.5	3.3	5.1	6.8	8.1	8.8	9.0	8.9	8.8	60.6
Increase or Decrease (-) in the Deficit	0.2	-0.5	-1.8	-3.1	-4.3	-5.6	-6.3	-6.5	-6.4	-6.3	-40.6
Option 2: Increase Appropriations by \$40 Billion											
Change in Outlays	1.0	2.0	3.0	4.0	5.0	5.0	5.0	5.0	5.0	5.0	40.0
Change in Revenues	0.7	3.0	6.3	9.4	11.9	13.7	14.6	14.8	14.7	14.4	103.1
Increase or Decrease (-) in the Deficit	0.3	-1.0	-3.3	-5.4	-6.9	-8.7	-9.6	-9.8	-9.7	-9.4	-63.1



Audit Rates are Way Down

Table 2: Audit Rates, 2010 vs. 2018

Decline in Audit Rates by Filer Category			
Filer Category	Percent Audited		Percent Decline
	2010	2018	
All Filers	0.93%	0.51%	-45.39%
Individuals	1.11%	0.59%	-46.30%
EITC recipients	2.39%	1.41%	-41.10%
With annual income over \$1 million	8.36%	3.23%	-61.35%
\$1 million - \$ 5 million	6.67%	2.21%	-66.87%
\$5 million - \$ 10 million	11.55%	4.21%	-63.55%
\$ 10 million +	18.38%	6.66%	-63.76%
Corporations	1.39%	0.88%	-36.54%
With assets over \$20 billion	97.99%	49.29%	-49.70%
Employment	0.21%	0.14%	-33.63%
Estates	10.12%	8.60%	-15.01%
With assets over \$5 million	24.31%	18.71%	-23.07%

Source: IRS Statistics of Income Databook. Audit rates by annual income are imputed from Table 9b; all other data are from Table 9a.



The Trump Plan

	OMB Ten-Year Savings	CBO Ten-Year Savings
Increase IRS tax enforcement funding (cost)	-\$15 billion	-\$15 billion
Increase IRS tax enforcement funding (revenue)	\$79 billion'	\$71 billion'
Give IRS more flexibility to address correctable errors	\$17 billion	\$0.3 billion
Strengthen enforcement of SSN requirement for tax credits	\$3 billion	not scored separately
Clarify worker classification rules, improve reporting requirements	\$2 billion	\$1 billion
Increase oversight of paid tax return preparers	\$0.5 billion	\$0.2 billion
Expand mandatory electronic filings of W-2s*	\$0.3 billion	<\$0.1 billion
Total	~\$87 billion	~\$60 billion

Note: Includes proposals from President Trump's FY2020 and FY2021 budget requests
Source: Office of Management and Budget



The Biden Plan

	OMB Ten-Year Savings
Increase IRS Tax Enforcement Funding	\$238 billion
Increase IRS tax enforcement funding (mandatory outlays)	-\$71 billion
Increase IRS tax enforcement funding (discretionary outlays)	-\$7 billion
Increase IRS tax enforcement funding (revenue)	\$316 billion
Information Reporting	\$463 billion
Introduce comprehensive financial account information reporting	\$463 billion
Expand broker information reporting with respect to cryptocurrency assets	N/A
Other Reforms	\$9.9 billion
Impose liability on shareholders to collect unpaid income taxes of applicable corporations	\$4.7 billion
Modify requisite supervisory approval of penalty included in notice	\$1.9 billion
Require Taxpayer Identification Numbers certification for reportable payments	\$1.8 billion
Extend statute of limitation on taxpayer noncompliance with listed transactions	\$0.7 billion
Allow IRS to regulate paid Federal tax return preparers	\$0.6 billion
Increase penalties on ghost preparers	\$0.2 billion
Expand Treasury's authority to require electronic filing of forms and returns	N/A
Total	\$711 billion

Note: Includes proposals from President Biden's FY2022 budget request
Source: Office of Management and Budget

The Bipartisan Plan

Invest \$40 billion over ten years in IRS funding in order to generate \$100 billion of net revenue

(Other details forthcoming)