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. Moreover, providing quality services to taxpayers is a necessary foundation for voluntary compliance. Such steps as periodically measuring noncompliance and its causes, setting tax gap reduction goals, 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 considering such factors as how well IRS uses its resources and the proper balance between taxpayer service and enforcement activities. If Congress provides IRS more enforcement resources, the amount of tax gap reduction would depend on factors such as the size of budget increases and the indirect increase in taxpayers’ voluntary compliance resulting from expanded enforcement. The recent budget request for fiscal year 2008 proposes legislation and new initiatives to reduce the tax gap but expected dollar gains are modest. Further reductions likely would require many more such changes.

What GAO Recommends

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


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.