



Highlights of [GAO-07-1062](#), a report to the Committee on Finance, U.S. Senate

TAX COMPLIANCE

Inflation Has Significantly Decreased the Real Value of Some Penalties

Why GAO Did This Study

Civil tax penalties are an important tool to encourage taxpayer compliance with the tax laws. A number of civil tax penalties have fixed dollar amounts—a specific dollar amount, a minimum or maximum amount—that are not indexed for inflation. Because of your concerns that civil penalties are not effectively achieving their purposes, we agreed to (1) determine the potential effect of adjusting civil tax penalties for inflation on the Internal Revenue Service’s (IRS) assessment and collection amounts and (2) describe the likely administrative impact of regularly adjusting civil tax penalties on IRS and tax practitioners. GAO examined IRS data on civil tax penalties and conducted interviews with IRS employees and tax practitioners.

What GAO Recommends

Congress should consider requiring IRS to periodically adjust for inflation, and round appropriately, the fixed dollar amounts of civil tax penalties to account for the decrease in real value over time and so that penalties for the same infraction are consistent over time. IRS provided technical comments on a draft of this report that have been incorporated where appropriate.

www.gao.gov/cgi-bin/getrpt?GAO-07-1062.

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

Adjusting civil tax penalties for inflation on a regular basis to maintain their real values over time may increase IRS collections by tens of millions of dollars per year. Further, the decline in real value of the fixed dollar amounts of civil tax penalties may weaken the deterrent effect of these penalties and may result in the inconsistent treatment of taxpayers over time. If civil tax penalty fixed dollar amounts were adjusted for inflation, the estimated increase in IRS collections would have ranged from \$38 million to \$61 million per year from 2000 to 2005. Almost all of the estimated increase in collections was generated by four penalties. These increases result because some of the penalties were set decades ago and have decreased significantly in real value—by over one-half for some penalties.

Estimated Increase in IRS Assessments and Collections from Inflation Adjusting of Penalties Assessed, 2000 – 2005

Dollars in millions

Assessment year	Penalty adjusted assessment increase	Penalty adjusted collections increase
2000	\$100.4	\$38.2
2001	254.9	42.1
2002	165.3	47.9
2003	267.1	53.2
2004	320.9	61.0
2005	280.5	60.3

Source: GAO analysis of IRS data.

According to those we interviewed, the likely administrative burden associated with adjusting the fixed dollar amounts of civil tax penalties for inflation on a regular basis would not be significant for IRS and would be low for tax practitioners. However, officials from the Office of Penalties, a relatively small office that would be responsible for coordinating the required changes among multiple IRS divisions, said that such adjustments might be considerable depending on the number of penalties being adjusted and would require a reprioritization of work. IRS officials said that the work required would be easier to implement with each subsequent update.