



Highlights of [GAO-06-453T](#), a testimony before the Committee on the Budget, U.S. Senate

### Why GAO Did This Study

The Internal Revenue Service's (IRS) most recent estimate of the difference between what taxpayers timely and accurately paid in taxes and what they owed was \$345 billion. IRS estimates it will eventually recover some of this tax gap, resulting in an estimated net tax gap of \$290 billion. The tax gap arises when taxpayers fail to comply with the tax laws by underreporting tax liabilities on tax returns; underpaying taxes due from filed returns; or nonfiling, which refers to the failure to file a required tax return altogether or in a timely manner.

The Chairman and Ranking Minority Member of the Senate Committee on the Budget asked GAO to present information on the causes of and possible solutions to the tax gap. This testimony addresses the nature and extent of the tax gap and the significance of reducing the tax gap, including some steps that may assist with this challenging task. For context, this testimony also addressed GAO's most recent simulations of the long-term fiscal outlook and the need for a fundamental reexamination of major spending and tax policies and priorities.

### What GAO Recommends

GAO is not making any new recommendations but discusses some past recommendations and highlights some new areas for possible attention.

[www.gao.gov/cgi-bin/getrpt?GAO-06-453T](http://www.gao.gov/cgi-bin/getrpt?GAO-06-453T).

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](mailto:brostekm@gao.gov).

## TAX GAP

# Making Significant Progress in Improving Tax Compliance Rests on Enhancing Current IRS Techniques and Adopting New Legislative Actions

### What GAO Found

Our nation's fiscal policy is on an imprudent and unsustainable course. As long-term budget simulations by GAO show, over the long term we face a large and growing structural deficit due primarily to known demographic trends, rising health care costs, and lower federal revenues as a percentage of the economy. GAO's simulations indicate that the long-term fiscal challenge is too big to be solved by economic growth alone or by making modest changes to existing spending and tax policies. Rather, a fundamental reexamination of major policies and priorities will be important to recapture our future fiscal flexibility.

Underreporting of income by businesses and individuals accounted for most of the estimated \$345 billion tax gap for 2001, with individual income tax underreporting alone accounting for \$197 billion, or over half of the total gap. Corporate income tax and employment tax underreporting accounted for an additional \$84 billion of the gap.

Reducing the tax gap would help improve fiscal sustainability. Given the tax gap's persistence and size, it will require considering not only options that have been previously proposed but also new administrative and legislative actions. Even modest progress would yield significant revenue; each 1 percent reduction would likely yield nearly \$3 billion annually. Reducing the tax gap will be a challenging long-term task, and progress will require attacking the gap with multiple strategies over a sustained period. These strategies could include efforts to regularly obtain data on the extent of, and reasons for, noncompliance; simplify the tax code; provide quality service to taxpayers; enhance enforcement of tax laws by utilizing enforcement tools such as tax withholding, information reporting, and penalties; leverage technology; and optimize resource allocation.

**IRS's Tax Year 2001 Gross Tax Gap Estimates by Type of Noncompliance and Type of Tax**

Dollars in billions

Type of noncompliance	Type of tax					Total
	Individual income	Corporate income	Employment	Estate	Excise	
Underreporting	\$197	\$30	\$54	\$4	No estimate	\$285
Underpayment	23	2	5	2	\$1	\$34
Nonfiling	25	No estimate	No estimate	2	No estimate	\$27
<b>Total</b>	<b>\$244</b>	<b>\$32</b>	<b>\$59</b>	<b>\$8</b>	<b>\$1</b>	<b>\$345</b>

Source: IRS.

Note: Figures may not sum to totals due to rounding.