

Why GAO Did This Study

The Joint Committee on Taxation identified improved taxpayer compliance with the real-estate tax deduction as a way to reduce the federal tax gap—the difference between taxes owed and taxes voluntarily and timely paid.

Regarding the deduction, GAO was asked to examine (1) factors that contribute to taxpayers including nondeductible charges, (2) the extent that taxpayers may be claiming such charges, (3) the extent that Internal Revenue Service (IRS) examinations focus on the inclusion of such charges, and (4) possible options for improving taxpayer compliance. GAO surveyed a generalizable sample of local governments, studied taxpayer compliance in two jurisdictions that met selection criteria, reviewed IRS documents, and interviewed government officials and others. Addressing the complexity of current tax law on real-estate tax deductions was outside the scope of this review.

What GAO Recommends

GAO recommends that the Commissioner of Internal Revenue change IRS guidance to taxpayers, revise IRS guidance for auditing the deduction, identify a cost-effective means of obtaining information on tax bill charges, and conduct outreach to local governments and others on options for helping taxpayers comply. IRS agreed with most of the recommendations, but disagreed with changing guidance for auditing the deduction. GAO continues to believe it should be improved.

[View GAO-09-521 or key components.](#)
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May 2009

REAL ESTATE TAX DEDUCTION

Taxpayers Face Challenges in Determining What Qualifies; Better Information Could Improve Compliance

What GAO Found

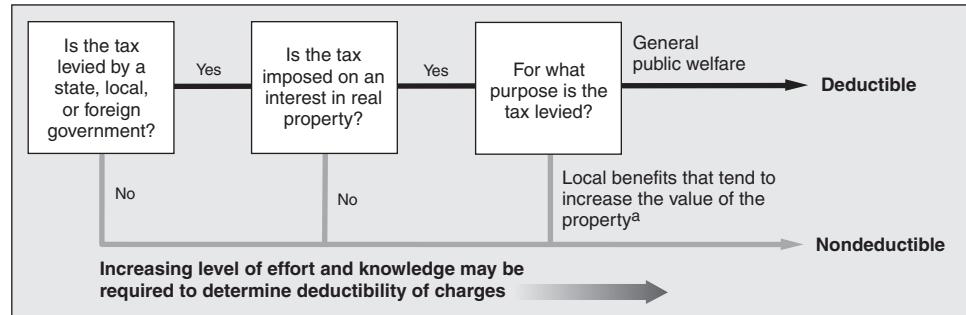
Taxpayers who itemize federal income-tax deductions and whose local real-estate tax bills include nondeductible charges face challenges determining what real-estate taxes they can deduct on their federal income tax returns. Neither local-government tax bills nor mortgage-servicer documents identify what taxpayers can properly deduct. Without such information, determining deductibility can be complex and involve significant effort. While IRS guidance for taxpayers discusses what qualifies as deductible, it does not indicate that taxpayers may need to check both tax bills and other information sources to make the determination. In addition, tax software and paid preparers may not ensure that taxpayers only deduct qualified amounts.

There are no reliable estimates for the extent of noncompliance caused by taxpayers claiming nondeductible charges, or the associated federal tax loss. However, GAO estimates that almost half of local governments nationwide included generally nondeductible charges on their bills. While the full extent of overstatement is unknown due to data limitations, GAO estimates that taxpayers in two counties collectively overstated their deductions by at least \$23 (or \$46 million using broader matching criteria).

IRS examinations of real-estate tax deductions focus more on whether the taxpayer owned the property and paid the taxes than whether the taxpayer claimed only deductible amounts, primarily because nondeductible charges are generally small. IRS guidance does not require examiners to request proof of deductibility or direct them to look for nondeductible charges on tax bills.

Various options could improve compliance with the real-estate tax deduction, such as providing taxpayers with better guidance and more information, and increasing IRS enforcement. However, the lack of information regarding the extent of noncompliance and the associated tax loss makes it difficult to evaluate these options. If IRS obtained information on real-estate tax bill charges, it could find areas with potentially significant noncompliance and use targeted methods to reduce noncompliance in those areas.

Determining What Qualifies As Deductible Is Complex



Source: GAO analysis of Internal Revenue Code provisions.

^aCharges for the repair or maintenance of local benefits and associated interest are deductible.