

SENATE TAXATION

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Federal Tax Compliance Research

Individual Income Tax Gap Estimates
for 1985, 1988, and 1992



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EXECUTIVE SUMMARY

This report presents current Internal Revenue Service estimates of the individual income tax gap. Both gross and net tax gap estimates are presented. The gross tax gap is the amount of "true" tax liability for a particular tax year that is not paid voluntarily and timely. The net tax gap is the gross tax gap minus the amount of tax remitted late or collected by IRS through its enforcement activities. The estimates relate only to payment of tax on income earned in legal activities. For example, the income tax due but not paid on income from distribution of narcotics is not included.

Both gross and net tax gaps consist of three main components: nonfiling, underreporting, and underpayment. The nonfiling gap is the amount of tax liability owed by taxpayers who do not voluntarily and timely file returns. The underreporting gap is the amount of tax liability not voluntarily reported by taxpayers who do file returns. The underpayment gap is the amount of tax liability that individuals report on their tax returns, but do not pay voluntarily and timely.

Our estimates of the gross individual income tax gap for tax year (TY) 1992 range from \$93.2 to \$95.3 billion. Of this amount, the nonfiling gap accounts for an estimated \$13.5 to \$13.8 billion. The underreporting gap is estimated to account for another \$71.3 to \$73.1 billion, while our estimate of the underpayment gap is \$8.4 billion. We estimate total "true" individual income tax liability to be \$550.2 to \$552.3 billion for TY 1992. Therefore, our estimates of the overall individual noncompliance rate (the gross tax gap as a percentage of the "true" tax liability) for TY 1992 range from 16.9 to 17.3 percent.

The net tax gap is the gross tax gap less amounts remitted late or collected as the result of enforcement. We estimate that IRS enforcement actions will eventually bring in \$14.9 billion of TY 1992 revenue. Of this amount, an estimated \$3.2 billion relates to the nonfiling gap, \$6.9 billion to the underreporting gap, and \$4.8 billion to the underpayment gap. Hence our estimates of the net tax gap for TY 1992 range from \$78.3 to \$80.4 billion. Of this amount, the net nonfiling gap accounts for an estimated \$10.3 to \$10.6 billion. The net underreporting gap is estimated to account for another \$64.4 to \$66.2 billion, while our estimate of the net underpayment gap is \$3.6 billion.

Previously published IRS individual income tax gap estimates were based primarily on compliance data for TY 1982 and earlier years. The estimates presented in this report are derived from more recent compliance data, particularly Taxpayer Compliance Measurement Program (TCMP) examinations of individual income returns filed for TY 1985 and TY 1988, and the TCMP survey of nonfilers for TY 1988. The current estimates also reflect changes in tax law including changes from the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1990.

A. Gross Tax Gap

Table 1 presents our estimates of the gross individual income tax gap by main gap components for tax years 1985, 1988, and 1992. The estimated gross gap ranges from \$68.9 to \$70.4 billion for TY 1985, from \$79.3 to \$80.9 billion for TY 1988, and from \$93.2 to \$95.3 billion for TY 1992.

Tax Gap Component	TY 1985		TY 1988		TY 1992	
	Low	High	Low	High	Low	High
Nonfiling Gap						
Total	9.6	9.8	11.0	11.2	13.5	13.8
Underreporting Gap						
Underreported Income	43.6	44.6	46.0	47.1	57.2	58.6
Overstated Offsets	8.8	9.1	10.9	11.3	14.0	14.4
Net Math Error	-0.2	-0.2	0.2	0.2	0.1	0.1
Total	52.2	53.5	57.1	58.5	71.3	73.1
Underpayment Gap						
Total	7.1	7.1	11.2	11.2	8.4	8.4
Gross Tax Gap	68.9	70.4	79.3	80.9	93.2	95.3
Voluntarily and Timely Paid	303.3	303.3	381.4	381.4	457.0	457.0
"True" Tax Liability	372.2	373.7	460.7	462.3	550.2	552.3

Table 2 puts the relative importance of the components of the tax gap in perspective by presenting them as percentages of the estimated "true" tax liability for tax years 1985, 1988, and 1992. The ranges of our estimates of the overall gross noncompliance rate (the gross tax gap as

a percentage of the "true" tax liability) are 18.5 to 18.8 percent for TY 1985, 17.2 to 17.5 percent for TY 1988, and 16.9 to 17.3 percent for TY 1992. The estimated improvement in overall compliance from 1985 to 1988 is due primarily to estimated improvements in the underreporting gap portion of the total. The 1992 figures are projections based on 1988 compliance rates. The small improvement from 1988 to 1992 is due to a change in the composition of income reported between types with relatively low compliance rates and types with relatively high compliance rates.

Tax Gap Component	TY 1985		TY 1988		TY 1992	
	Low	High	Low	High	Low	High
Nonfiling Gap						
Total	2.6	2.6	2.4	2.4	2.5	2.5
Underreporting Gap						
Underreported Income	11.7	11.9	10.0	10.2	10.4	10.6
Overstated Offsets and Credits	2.6	2.4	2.4	2.4	2.6	2.6
Net Math Errors	-0.1	-0.1	<0.05	<0.05	<0.05	<0.05
Total	14.0	14.3	12.4	12.7	13.0	13.2
Underpayment Gap						
Total	1.9	1.9	2.4	2.4	1.5	1.5
Gross Tax Gap	18.5	18.8	17.2	17.5	16.9	17.3
Voluntarily and Timely Paid	81.5	81.2	82.8	82.5	83.1	82.7
"True" Tax Liability	100.0	100.0	100.0	100.0	100.0	100.0

Note: detail may not add to total due to rounding.