

Montana Department of
REVENUE

Tax Gap/Compliance

Define the problem

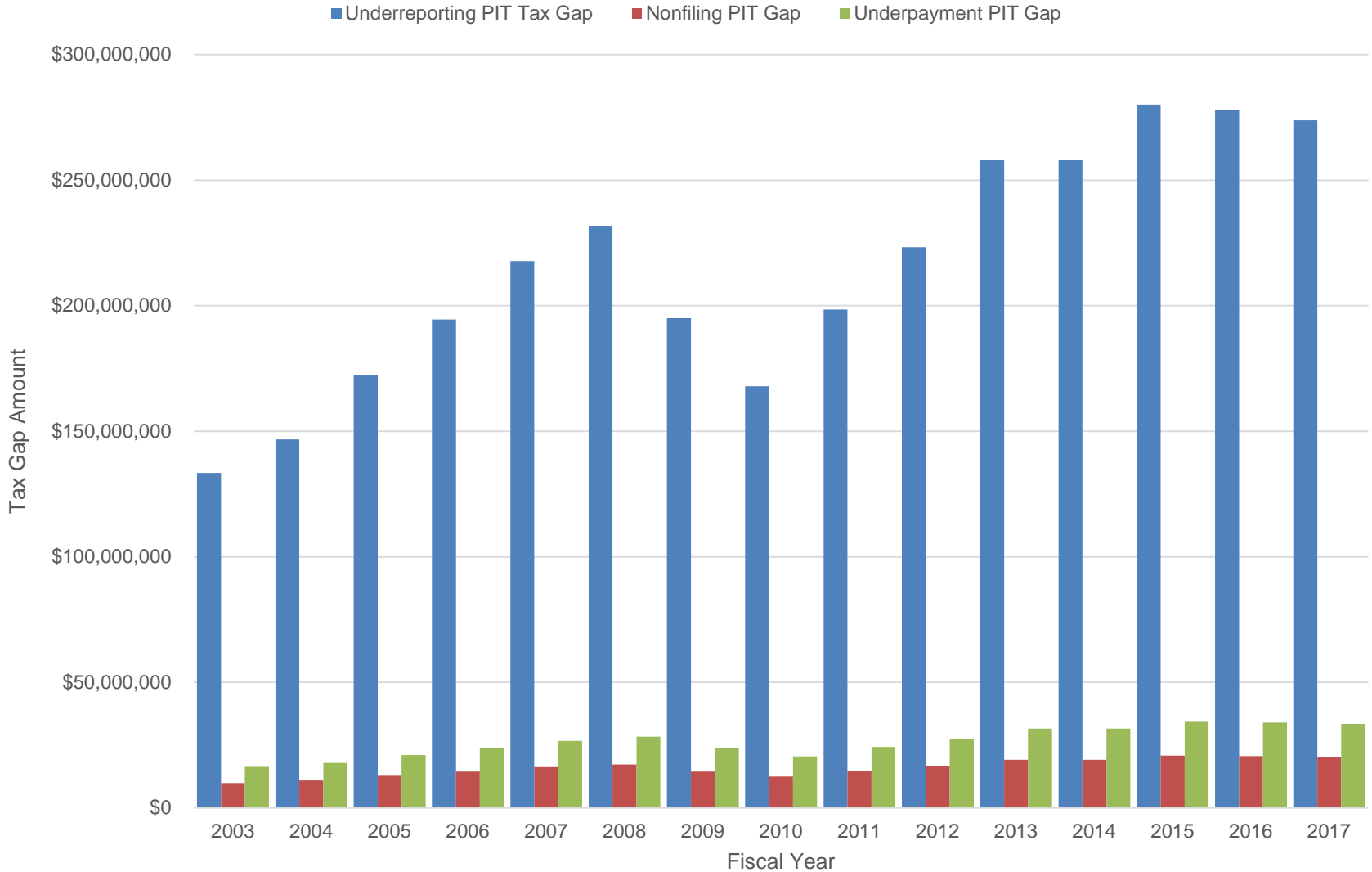
- What is the “tax gap?”
 - The “tax gap” is the difference between the amount of taxes owed and the amount voluntarily paid on time.
- How does the “tax gap” occur?
 - Three primary causes
 - **Non-filing**
 - **Underpayment**
 - **Underreporting of tax liability**

Figure 1	
National (IRS) Gross Tax Gap Estimates For Tax Years 2008 - 2010	
Gross Tax Gap	Annual Average (Billions of Dollars)
Nonfiling	\$32
Underreporting	\$387
Underpayment	\$39
Voluntary Compliance Rate	81.7%

Figure 2		
National Annual Average Gross Tax Gap Estimates For Tax Years 2008 - 2010		
Tax Gap Component	Tax Gap (Billions of Dollars)	Share of Gross Tax Gap
Gross Tax Gap	\$458	100%
Nonfiling Tax Gap	\$32	7.0%
Individual Income Tax	\$26	5.7%
Self-Employment Tax	\$4	0.9%
Estate Tax	\$2	0.4%
Underreporting Tax Gap	\$387	84.5%
Individual Income Tax	\$264	57.6%
Corporation Income Tax	\$41	9.0%
Employment Tax	\$81	17.7%
Estate Tax	\$1	0.2%
Underpayment Tax Gap	\$39	8.5%
Individual Income Tax	\$29	6.3%
Corporation Income Tax	\$3	0.7%
Employment Tax	\$6	1.3%
Estate Tax	\$1	0.2%



Montana Personal Income Tax Gap By Tax Gap Type Fiscal Years 2003 Through 2017



- Do all taxes collected by the department have a “tax gap”?
 - Yes
- How big is the gap?
 - It varies by tax
 - With income tax it varies by income type

Figure 3

National Average Annual Federal Underreporting Individual Income Tax Gap By Income Source, 2008 - 2010
(Billions of Dollars)

Tax Return Line Items	Total Tax Revenue Due	Reported Tax Revenue	Tax Gap	Net Misreporting Percentage
Gross Tax Gap			\$458	
Individual Income Tax Underreporting Tax Gap	\$1,200	\$936	\$264	22%
Wages, salaries, tips	\$500	\$495	\$5	1%
Interest income	\$33	\$32	\$1	3%
Dividend income	\$14	\$13	\$1	7%
State income tax refunds	\$8	\$7	\$1	13%
Pensions & annuities	\$125	\$120	\$5	4%
Unemployment Compensation	\$17	\$16	\$1	6%
Taxable Social Security benefits	\$37	\$30	\$7	19%
Partnership, S-Corp, Estate & Trust, etc	\$138	\$116	\$22	16%
Capital gains	\$41	\$30	\$11	27%
Short-term	\$46	\$40	\$6	13%
Long-term	\$38	\$33	\$5	13%
Form 4797 income	\$10	\$6	\$4	42%
Other income	\$59	\$30	\$29	49%
Nonfarm proprietor income	\$122	\$44	\$78	64%
Farm income	\$7	\$2	\$5	71%
Rents & royalties	\$32	\$12	\$20	62%
Other Taxes	\$33	\$32	\$1	3%
Unallocated Marginal Effects			\$12	
Income Offsets (Adjustments, Deductions, Exemptions)	\$380	\$361	\$19	5%
Total Credits	\$154	\$114	\$40	26%
Filing Status			\$5	



- Does the department know the “tax gap” for each tax it administer?
 - Kind of
 - We have estimates based on compliance research by the IRS
 - Why doesn't the department do its own research?
 - Compliance research is resource and time intensive
 - Taxpayers don't like to be audited for the sake of research

Figure 4

Average Annual Montana Underreporting Individual Income Tax Gap By Income Source, 2016

Tax Return Line Items	Total Income	Reported Income	Reported Losses	Amount Mis-Reported	Net Misreporting Percentage
Individual Income Tax Underreporting Tax Gap					
Wages, salaries, tips	\$16,961,548,131	\$16,791,932,650	\$0	\$169,615,481	1%
Interest income	\$305,003,079	\$295,852,987	\$0	\$9,150,092	3%
Dividend income	\$742,184,620	\$690,231,697	\$0	\$51,952,923	7%
State income tax refunds	\$128,649,722	\$111,925,258	\$0	\$16,724,464	13%
Pensions & annuities	\$3,123,519,218	\$2,998,578,449	\$0	\$124,940,769	4%
Unemployment Compensation	\$100,985,200	\$94,926,088	\$0	\$6,059,112	6%
Taxable Social Security benefits	\$1,211,783,826	\$981,544,899	\$0	\$230,238,927	19%
Rents, Royalties and Partnerships, S-Corp, Estate & Trust, etc	\$3,802,194,250	\$3,152,795,429	(\$501,916,236)	\$1,151,315,057	25%
Capital gains	\$2,251,472,796	\$1,680,082,250	(\$63,512,368)	\$634,902,914	27%
Form 4797 income	\$202,501,626	\$143,299,621	(\$63,284,694)	\$122,486,699	42%
Other income	(\$195,141,908)	\$132,515,405	(\$677,914,293)	\$350,256,980	49%
Nonfarm proprietor income	\$2,798,623,573	\$1,048,258,449	(\$185,656,941)	\$1,936,022,065	64%
Farm income	\$216,368,387	\$122,706,490	(\$353,555,224)	\$447,217,121	71%
Federal adjustments to income	\$508,553,396	\$536,806,362	\$0	\$28,252,966	5%
State additions to federal income	\$839,811,818	\$797,821,227	\$0	\$41,990,591	5%
State subtractions from federal income	\$1,592,930,557	\$1,681,426,699	\$0	\$88,496,142	5%
Deductions	\$5,092,000,521	\$5,374,889,439	\$0	\$282,888,918	5%
Exemptions	\$2,322,730,686	\$2,451,771,280	\$0	\$129,040,594	5%
Non-refundable Credits	\$27,474,820	\$42,357,014	\$0	\$14,882,194	26%
Refundable Credits	\$4,225,369	\$6,514,110	\$0	\$2,288,741	26%



Figure 5		
Simulated 2016 Full Year Resident Montana Tax Liability, Million of Dollars		
	Tax Liability	% Difference
With 2016 Returns	\$1,022	
With IRS Tax Gap Under-Reporting Estimates	\$1,244	21.7%

Figure 6	
Estimated FY 2017 Income Tax Revenue Less Compliance Revenue Plus Credits	
FY 2017 Income Tax Revenue	\$1,180,343,776
Revenue from Compliance and Amended Returns	- \$39,693,156
FY 2017 Current Income Tax Revenue	\$1,140,650,620
Estimated Credits	+ \$48,871,124
Estimated Current Income Tax Before Credits	\$1,189,521,744



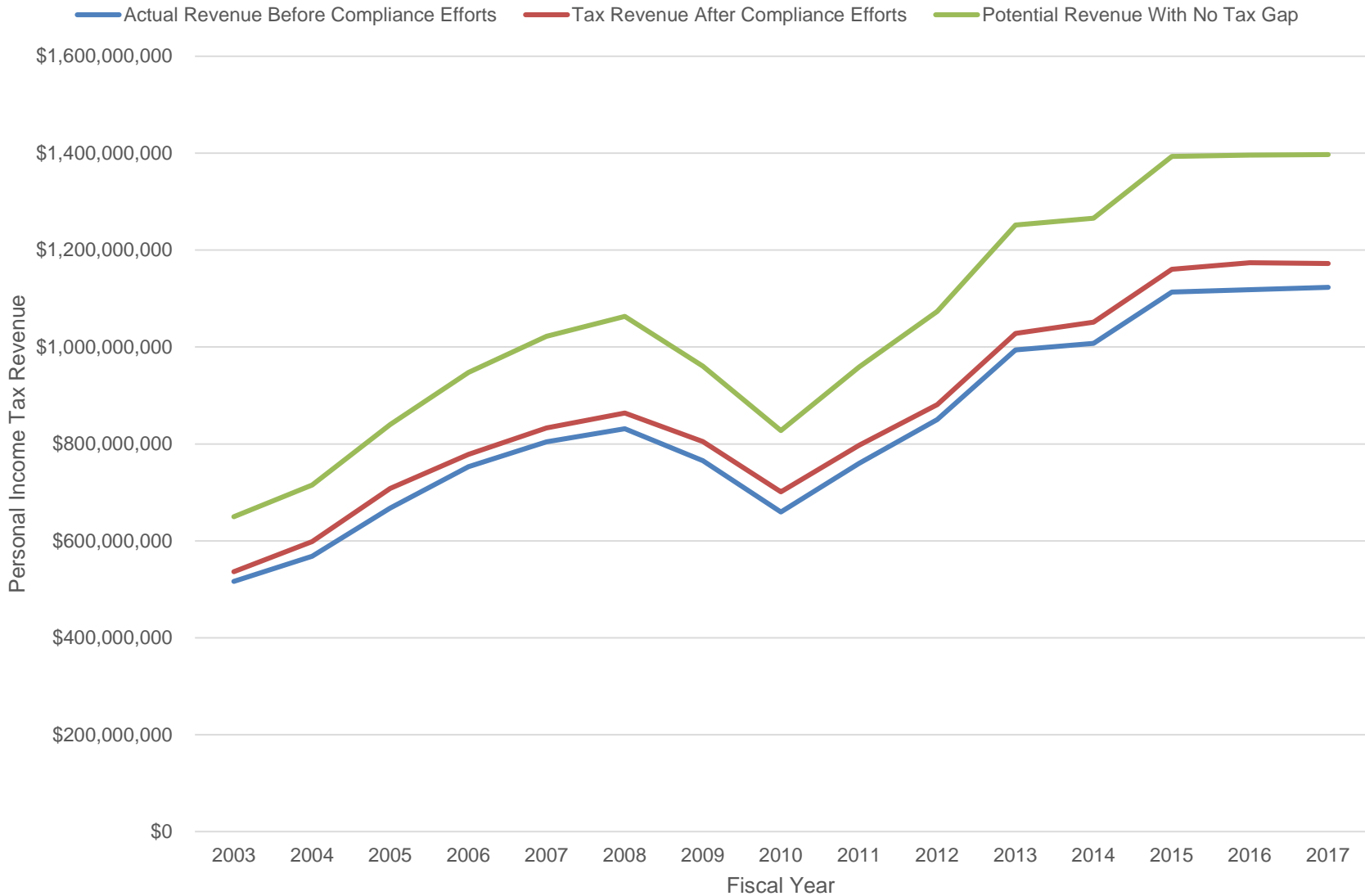
Figure 7	
Estimated FY 2017 Mis-Reporting Tax Gap for Montana Income Tax	
Estimated FY 2017 Current Income Tax Before Credits	\$1,189,521,744
Adjustment for Mis-Reporting of Income and Deductions	X 121.7%
Estimated Tax before Credits, Adjusted for Mis-Reporting of Income and Deductions	<u>\$1,447,448,839</u>
Estimated FY 2017 Credits	\$48,871,124
Adjustment for Mis-Reporting	X 74%
Estimated Credits Adjusted for Mis-Reporting	<u>\$36,164,632</u>
Estimated Tax before Credits, Adjusted for Mis-Reporting of Income and Deductions	\$1,447,448,839
Estimated Credits Adjusted for Mis-Reporting	- \$36,164,632
Estimated FY 2017 Income Tax Revenue Adjusted for Mis-Reporting	<u>\$1,411,284,207</u>
Estimated FY 2017 Income Tax Revenue Adjusted for Mis-Reporting	\$1,411,284,207
FY 2017 Current Income Tax Revenue	- \$1,140,650,620
Estimated Mis-Reporting Gap	<u>\$270,633,587</u>
Estimated % Mis-Reporting Gap	19.2%
Estimated Mis-Reporting Gap for FY 2005	\$243,088,000
Estimated % Mis-Reporting Gap for FY 2005	26.6%
Estimated Mis-Reporting Gap for FY 2015	\$287,210,655
Estimated % Mis-Reporting Gap for FY 2015	20.1%



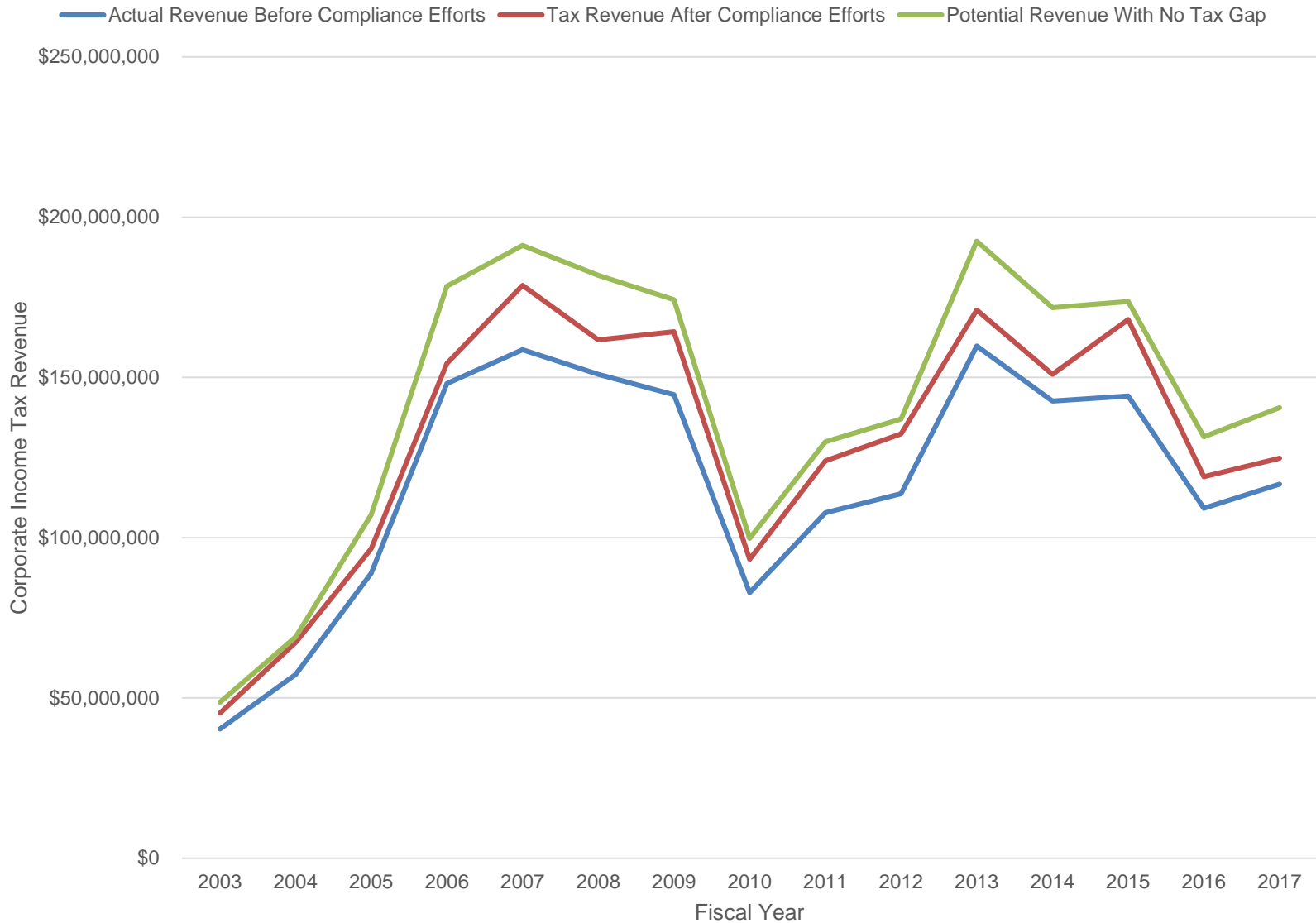
- Can we eliminate the “tax gap?”
 - No
 - We can reduce it through compliance programs, but never eliminate
 - Active compliance is a balance between the rights of the taxpayer and the needs of the State of Montana.
- If the state reduces the “tax gap” will it increase revenue without changing tax laws?
 - Yes
 - Policy makers determine the amount of time and resources the department dedicates to active compliance

Compliance

Montana Personal Income Tax Revenue and Tax Gap Estimates Fiscal Years 2003 Through 2017



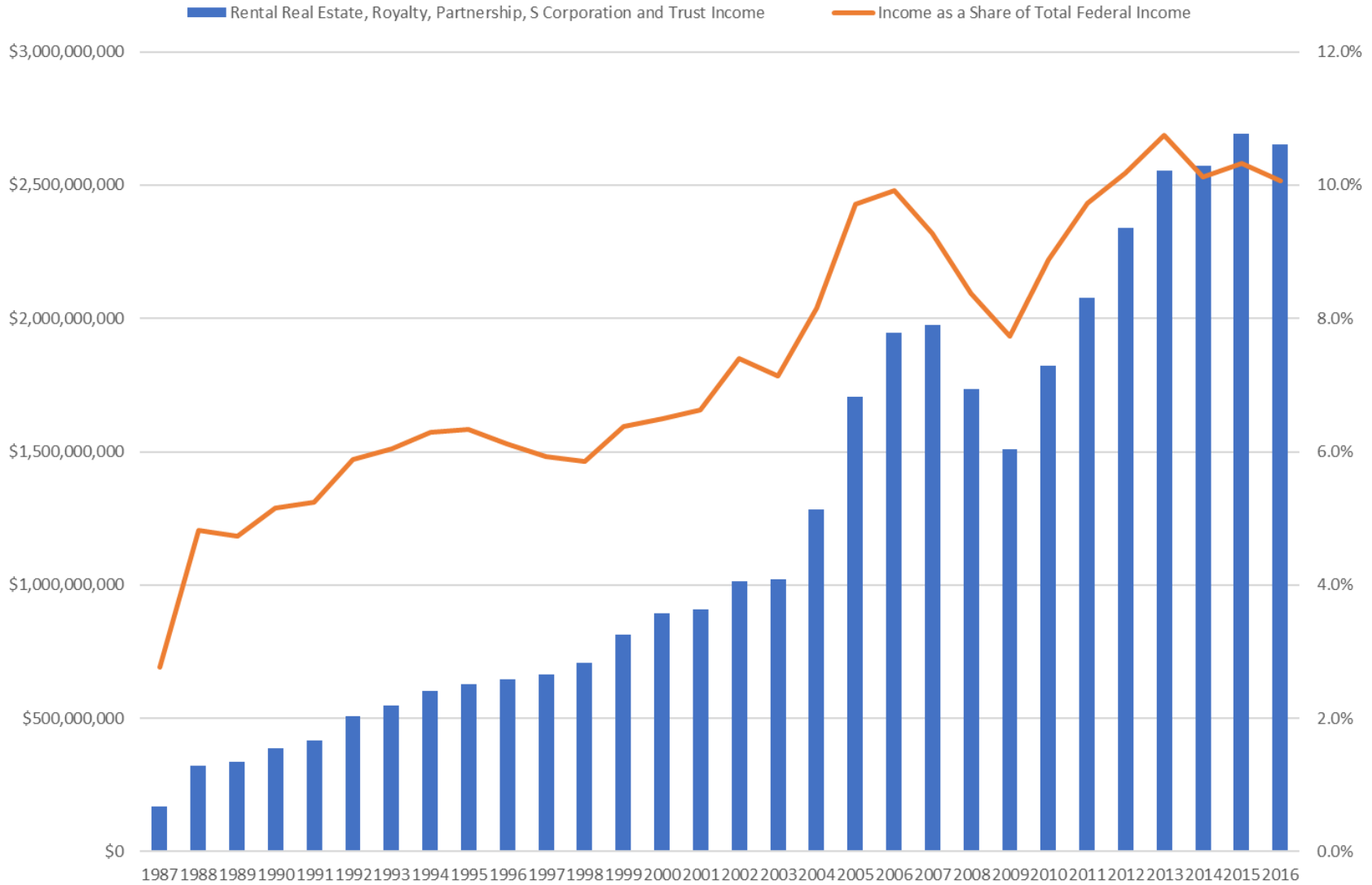
Montana Corporate Income Tax Revenue and Tax Gap Estimates Fiscal Years 2003 Through 2017



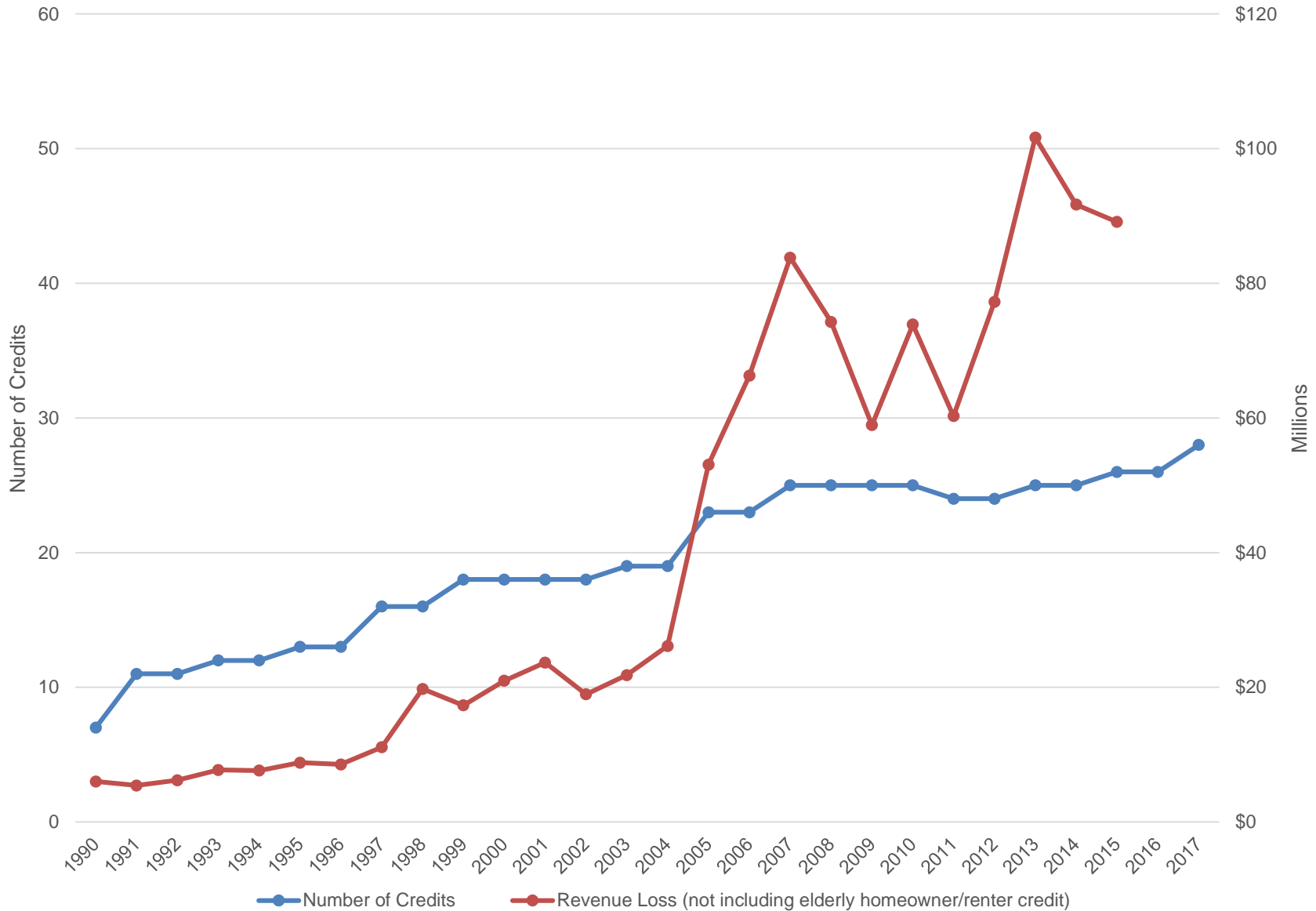
Examples

- Tax Credits
- Lack of Third Party Reporting
- Fraud
- Pass Through Income
- New Property

Rental Real Estate, Royalty, Partnership, S Corporation and Trust Income in Montana Tax Years 1987 Through 2016



Number of Credits Available Against Individual and Corporate Income Taxes And Revenue Loss From Credits



TY 2017 Impact of Centrally Assessed Intangible Personal Property Exclusion on the State of Montana General Fund

Centrally Assessed Property Type	'Foregone' Revenue
Telecom	8,363,217
Electric	4,095,289
Pipeline	1,422,540
Railroads	451,242
Electric Co-Op	142,264
Airline	121,116
<u>Telephone Co-Op</u>	<u>80,734</u>
<u>Total</u>	<u>14,676,400</u>