

A hand holding a silver pen over a white calculator on a wooden desk. The background is a blurred office setting with a computer monitor and a keyboard.

ISSUE BRIEF: Q3 2021

# CLOSING AMERICA'S "TAX GAP"

A THREE-PART PLAN FOR MODERNIZING THE IRS  
AND COLLECTING AN ADDITIONAL \$2.4 TRILLION  
IN TAXES OVER THE NEXT TWO DECADES

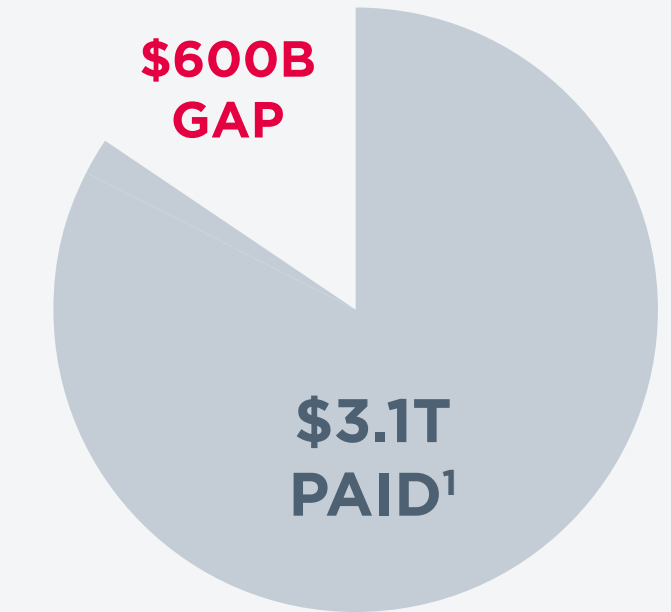


**BUSINESSFORWARD**  
FOUNDATION

## TOPLINE

1. WHAT AMERICANS OWE, MINUS WHAT THEY PAY = THE TAX GAP
2. THE SIZE OF THE TAX GAP SHOULD ALARM YOU
3. THE DISTRIBUTION OF THE TAX GAP SHOULD INFURIATE YOU
4. PART ONE: STOP ALLOWING WEALTHY TAXPAYERS TO “SELF-REPORT” THEIR BUSINESS INCOME
5. PART TWO: IMPROVE THE IRS IT SYSTEM TO BETTER TARGET THOSE WHO ARE NOT PAYING THEIR FAIR SHARE
6. PART THREE: REVERSE BUDGET CUTS THAT HOBBLLED IRS ENFORCEMENT, ENCOURAGED MISREPORTING, AND LEFT IT UNABLE TO PROVIDE ACCEPTABLE CUSTOMER SERVICE

**\$1 IN \$6  
GOES  
UNPAID**



**THE TOP 1%  
IS RESPONSIBLE  
FOR 28% OF  
THE TAX GAP<sup>2</sup>**

FROM 2010-2018...

**18%**  
IRS  
BUDGET CUTS



**1 IN 3**  
ENFORCEMENT  
EMPLOYEES LOST<sup>3</sup>

# THE VAST MAJORITY OF AMERICANS PAY WHAT THEY OWE

We can fix what's broken in our tax system by looking at what works. Each year, the IRS processes 253 million returns and forms in aggregate, including more than 150 million individual returns, and collects \$3.5 trillion in taxes.<sup>4</sup> Financial institutions produce around 3.3 billion income reports each year, and they already collect the information the IRS requires to shrink the tax gap.<sup>5</sup>

## MOST OF US EARN OUR INCOME IN WAYS THAT ARE VERIFIED TO THE IRS

Third-party verification of wages, interest on bank accounts, and earnings on retirement savings makes it easier for us to file our returns – and harder for us to misreport.



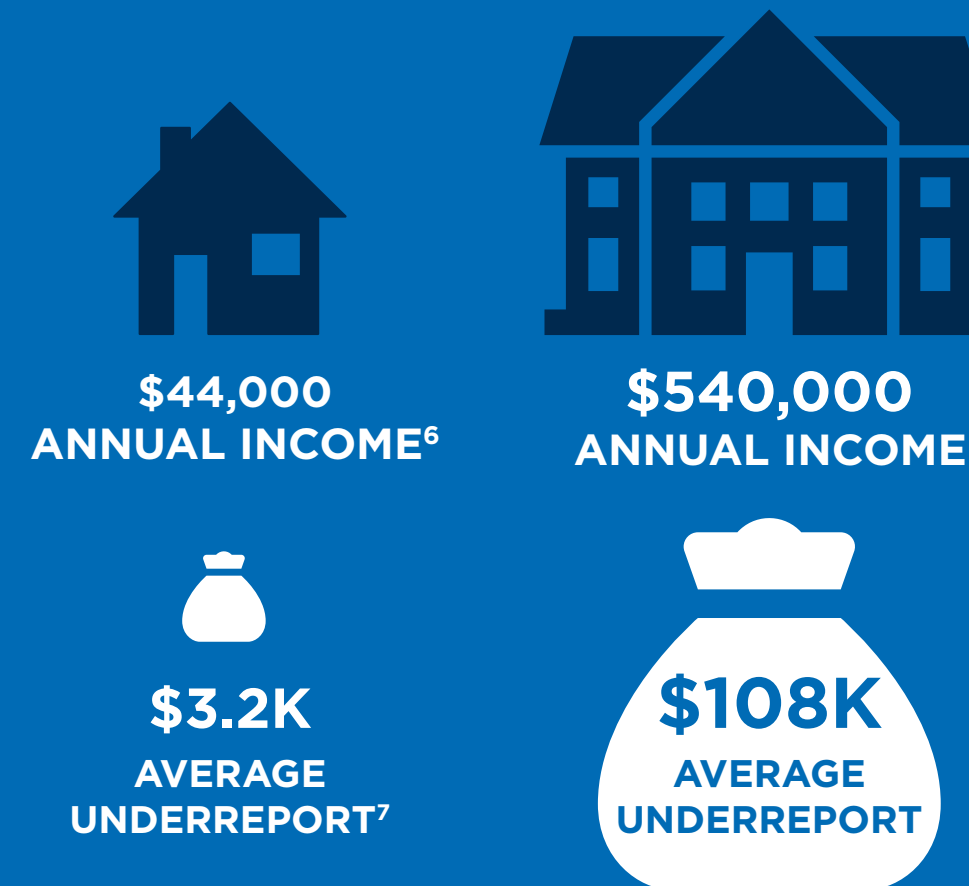
## A SMALL PORTION OF INCOME IS TREATED DIFFERENTLY

IRS rules allow taxpayers to “self-report” business income, and there is little, if any, third-party verification of what they report, so a disproportionate amount of misreporting occurs here.

VERIFIED INCOME	UNVERIFIED INCOME
WAGES	PROPRIETOR INCOME
SALARIES	PARTNERSHIP INCOME
SOCIAL SECURITY BENEFITS	
PENSIONS	

## A SMALL GROUP OF TAXPAYERS EARN THIS KIND OF INCOME, AND ONLY SOME OF THEM MISREPORT. BUT THOSE WHO DO COST US A LOT

A family in the top 1% underreports 34x more income than the median-income family.



## WE CAN CAPTURE BILLIONS IN UNPAID TAXES BY FOCUSING ON THIS SMALL GROUP OF TAXPAYERS

The top 1% (by income) is responsible for 28% of the tax gap. By focusing on increased information reporting and improving IRS technology, we can more effectively target the wealthiest people who fail to pay what they owe.<sup>8</sup>

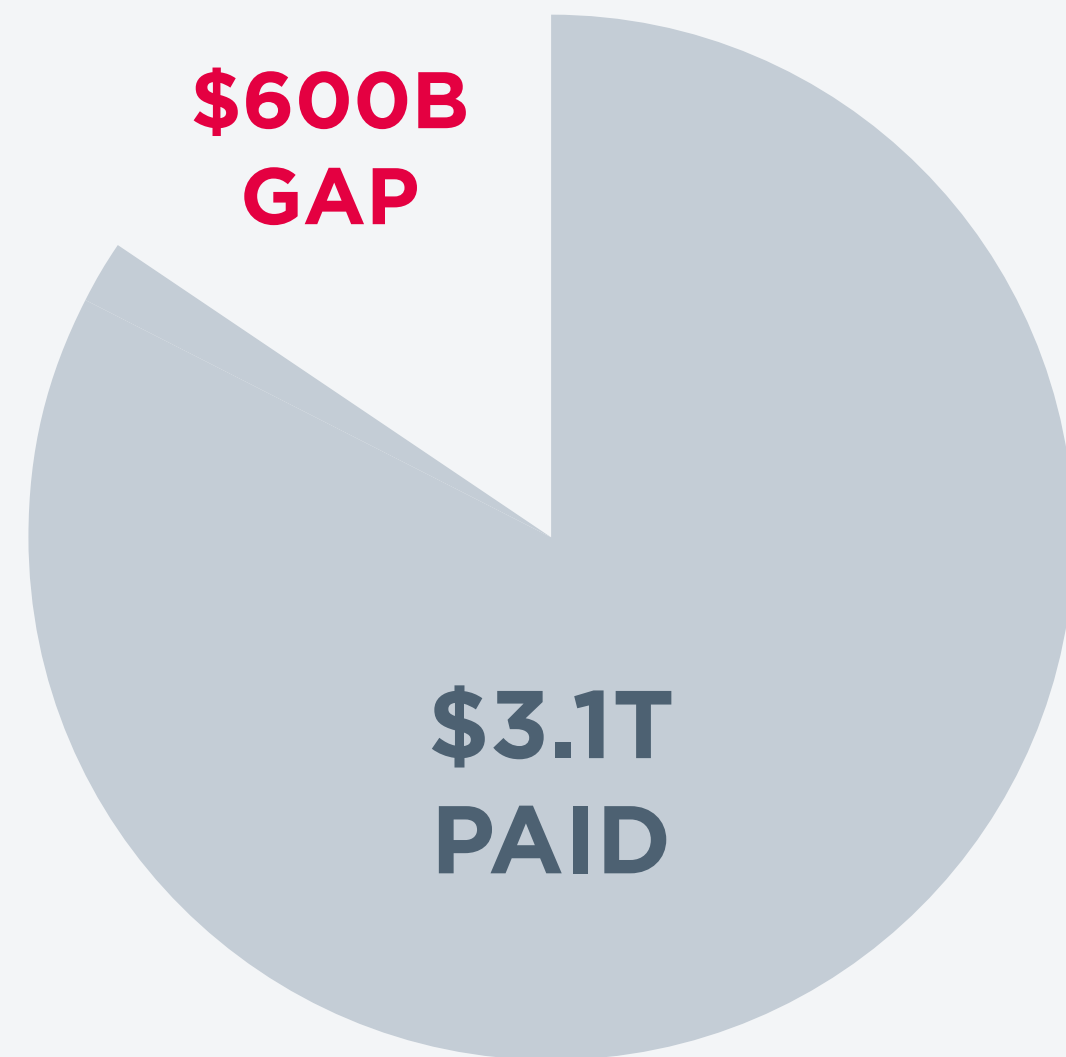
THE TOP 1% IS RESPONSIBLE FOR 28% OF THE TAX GAP



## WHAT THE TAX GAP MEANS TO YOU

**TAXPAYERS OWED NEARLY \$3.7 TRILLION IN 2019,  
BUT \$600 BILLION WENT UNPAID**

Even after the IRS enforcement activities and late payments, researches estimate that taxpayers should be paying an additional \$600 billion in taxes.<sup>9</sup>

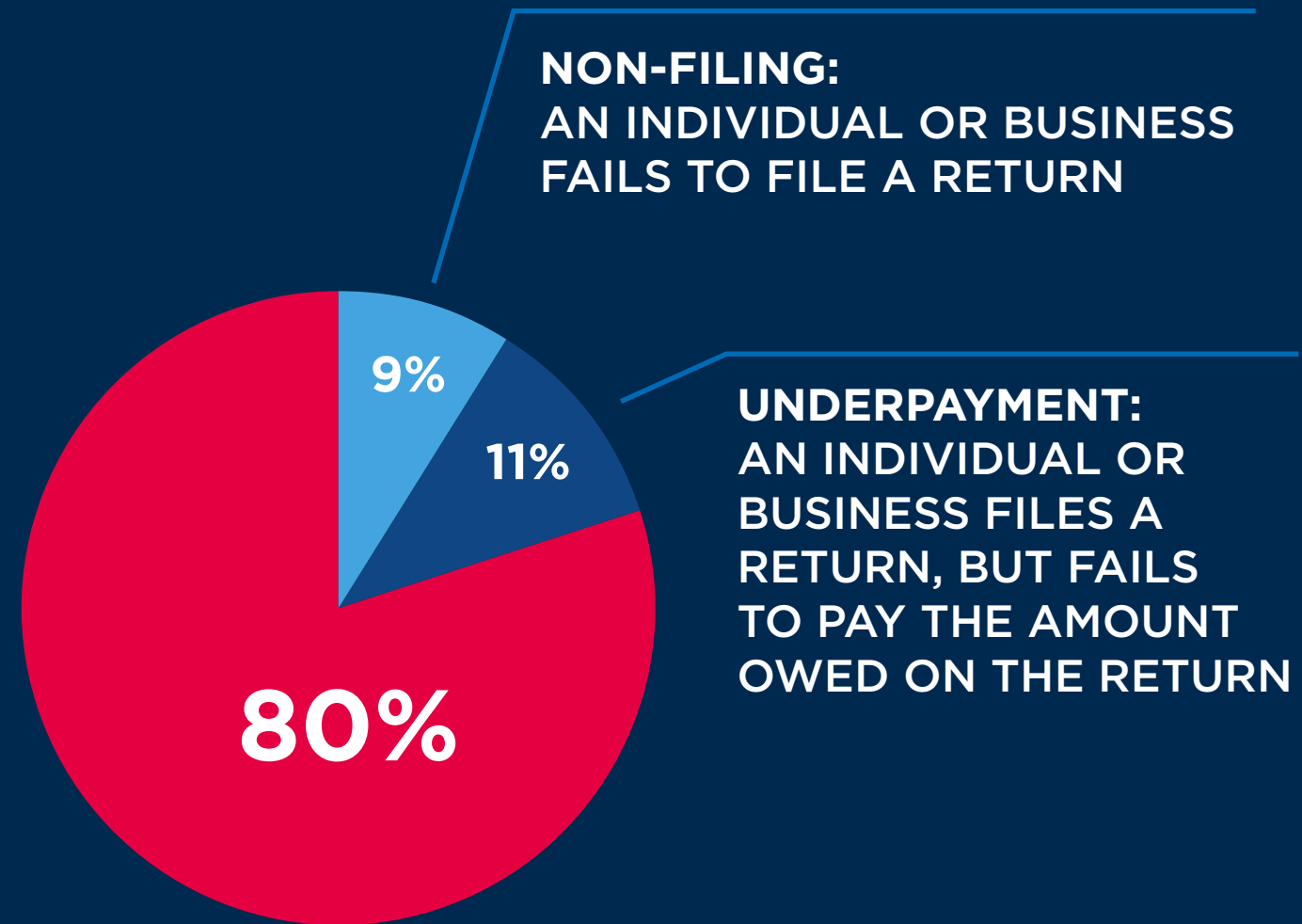


**THE TAX GAP KEEPS GROWING AND WILL TOTAL \$7 TRILLION OVER THE NEXT 10 YEARS<sup>10</sup>, LEAVING POLICYMAKERS WITH THREE BAD CHOICES:**

- 1. RAISE TAXES...**
- 2. CUT SPENDING ON PRIORITIES LIKE INFRASTRUCTURE, DEFENSE, AND HEALTHCARE, OR...**
- 3. LIVE WITH HIGHER DEFICITS THAN WE SHOULD**

# WHEN THE IRS ALLOWS A SMALL GROUP OF AMERICANS TO SELF-REPORT THEIR INCOME, MANY OF THEM HIDE THAT INCOME

**80% OF THE TAX GAP COMES FROM UNDERREPORTING INCOME<sup>11</sup>**



**NON-FILING:**  
AN INDIVIDUAL OR BUSINESS FAILS TO FILE A RETURN

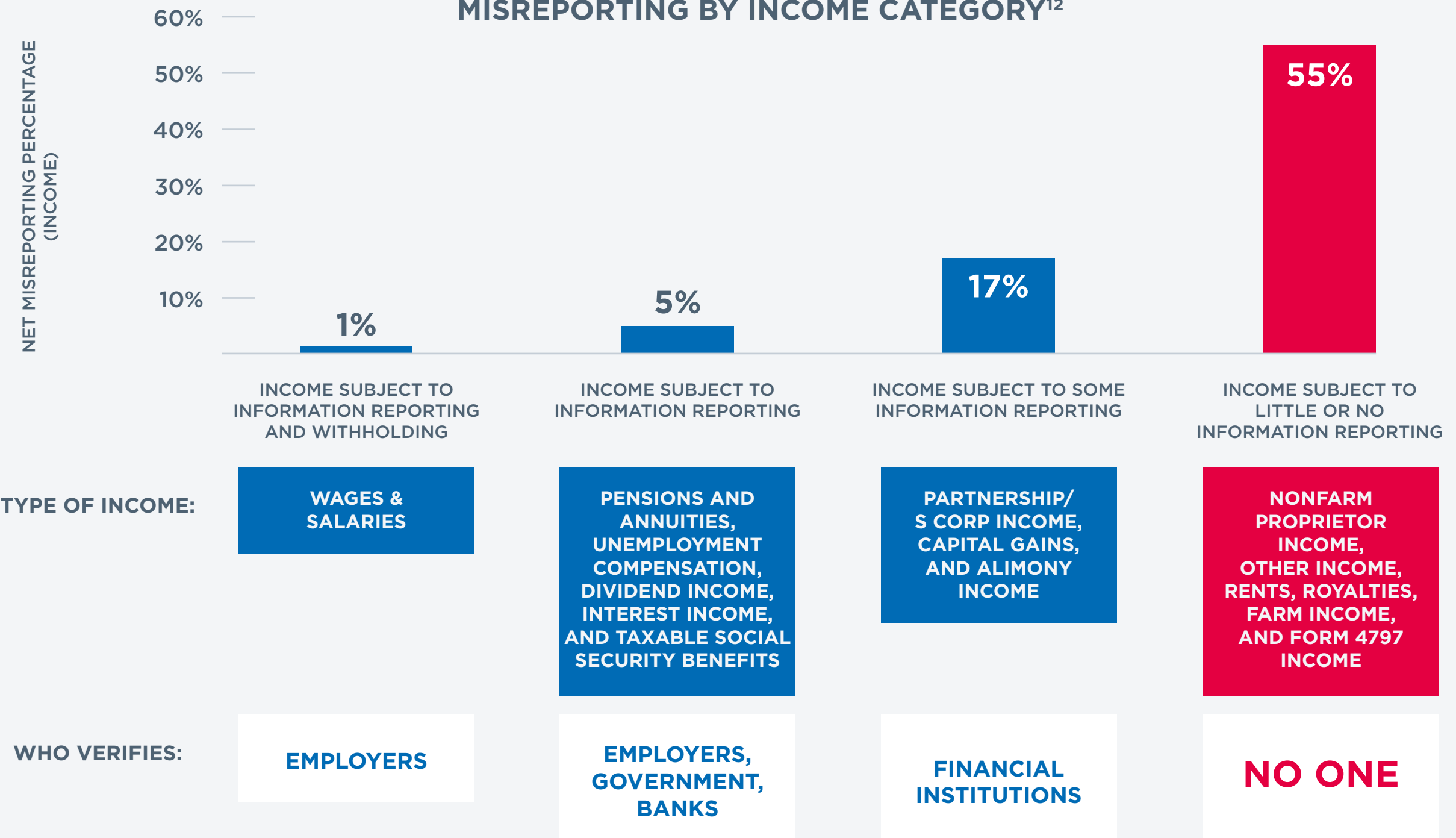
**UNDERPAYMENT:**  
AN INDIVIDUAL OR BUSINESS FILES A RETURN, BUT FAILS TO PAY THE AMOUNT OWED ON THE RETURN

**UNDERREPORTING:**  
AN INDIVIDUAL OR BUSINESS FILES A TAX RETURN BUT INCORRECTLY UNDERREPORTS THE TAXES IT OWES

**MORE THAN HALF OF BUSINESS INCOME NEVER GETS REPORTED, BECAUSE NO ONE VERIFIES WHAT TAXPAYERS SELF-REPORT**

Wages and most kinds of income that low- and middle-income families earn are subject to third-party reporting. (For example, your employer, bank, and broker verifies this income to the IRS with a W2, 1099, or other form). Without third-party reporting to reference, people are more likely to underreport their income and the IRS has a harder time verifying it.

**MISREPORTING BY INCOME CATEGORY<sup>12</sup>**



TYPE OF INCOME:

WAGES & SALARIES

PENSIONS AND ANNUITIES, UNEMPLOYMENT COMPENSATION, DIVIDEND INCOME, INTEREST INCOME, AND TAXABLE SOCIAL SECURITY BENEFITS

PARTNERSHIP/S CORP INCOME, CAPITAL GAINS, AND ALIMONY INCOME

NONFARM PROPRIETOR INCOME, OTHER INCOME, RENTS, ROYALTIES, FARM INCOME, AND FORM 4797 INCOME

WHO VERIFIES:

EMPLOYERS

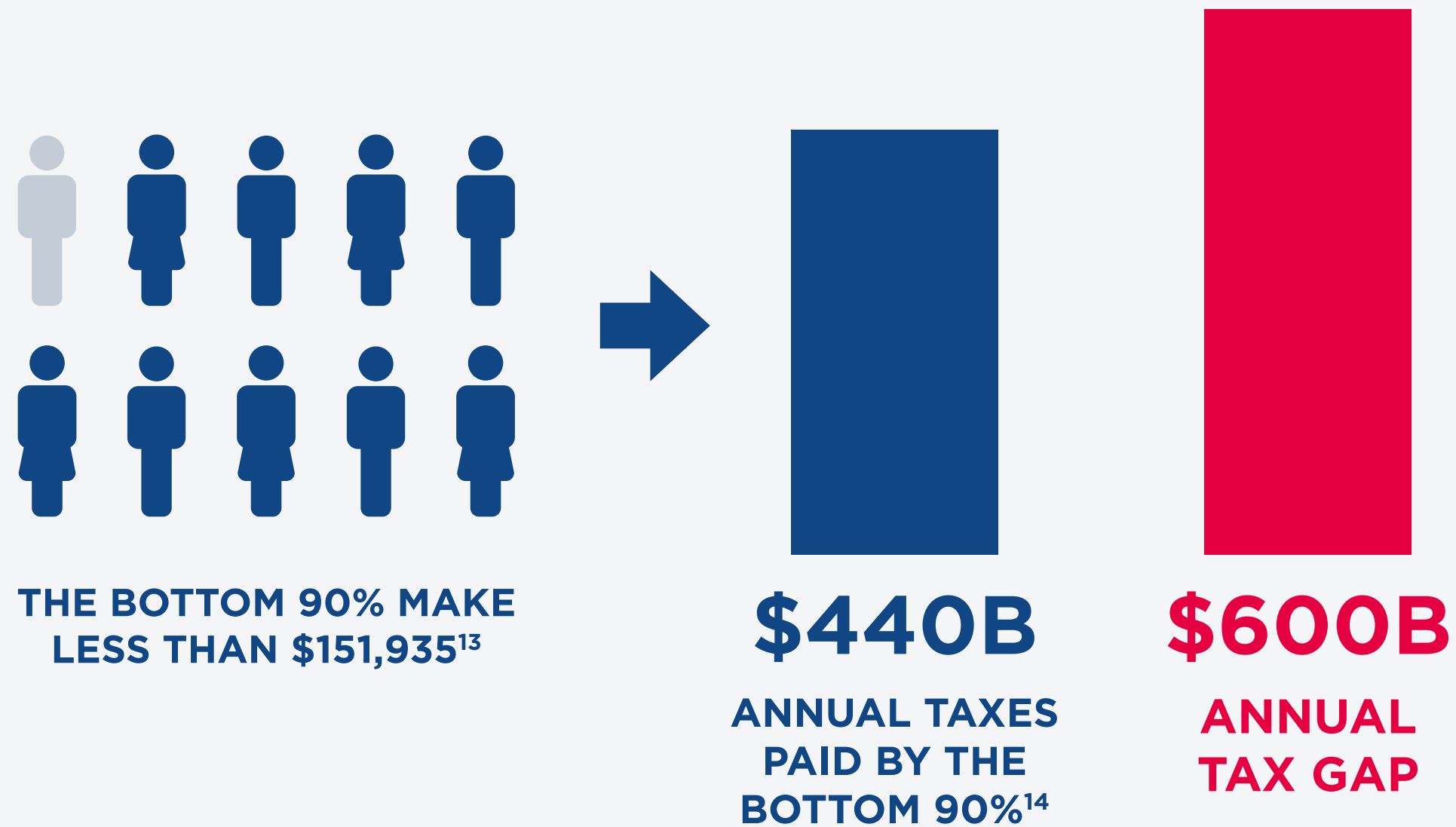
EMPLOYERS, GOVERNMENT, BANKS

FINANCIAL INSTITUTIONS

NO ONE

# THE SCALE OF THE TAX GAP SHOULD ALARM YOU

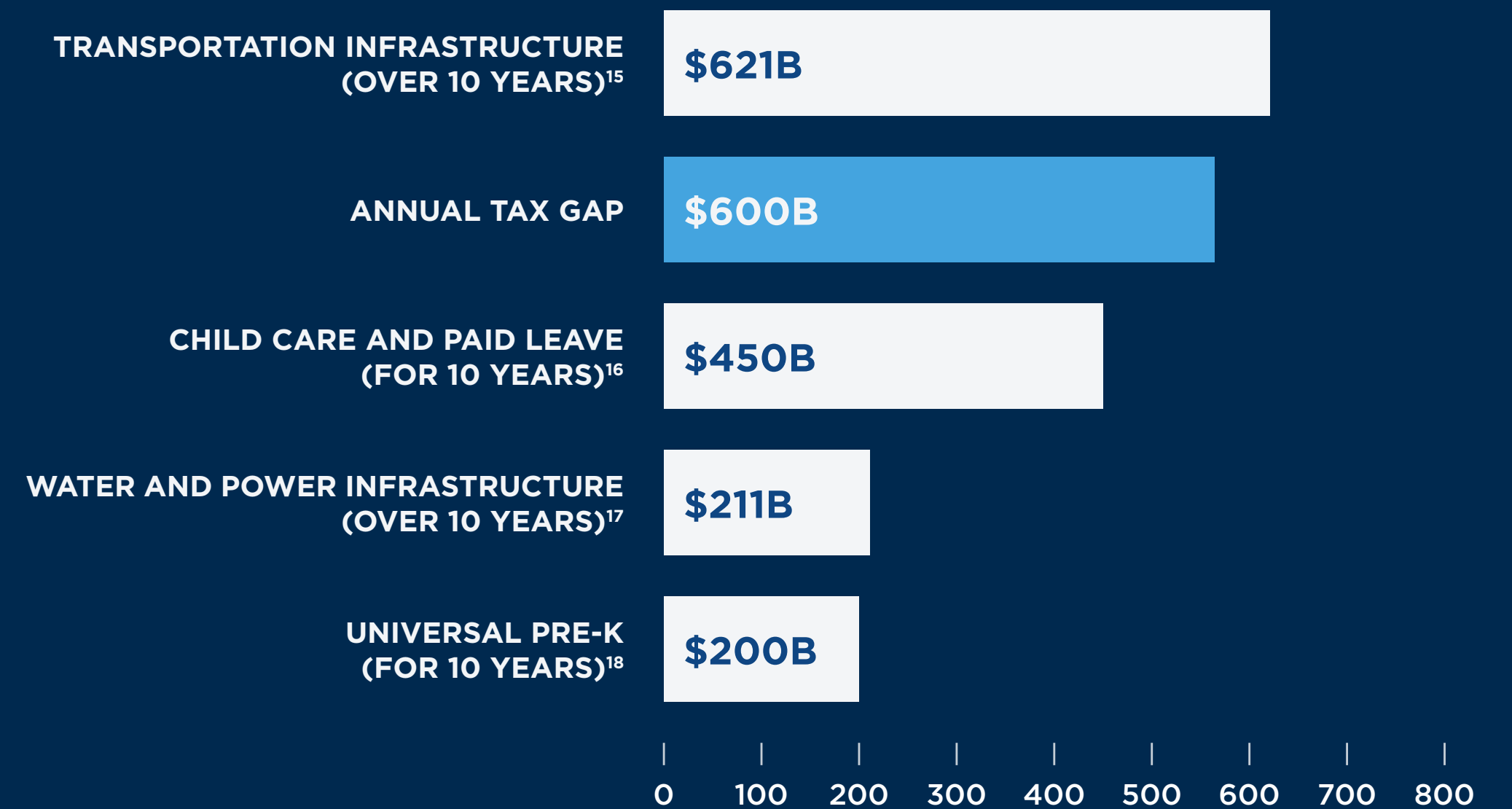
THE ANNUAL TAX GAP IS MORE THAN THE AMOUNT PAID BY THE BOTTOM 90% IN TAXES EVERY YEAR



WE COULD USE THE EQUIVALENT MONEY TO INVEST IN THE U.S. AND OUR WORKERS

Unpaid taxes could fund critical investments in infrastructure, child care, and education that would improve our workforce and economy in the long run.

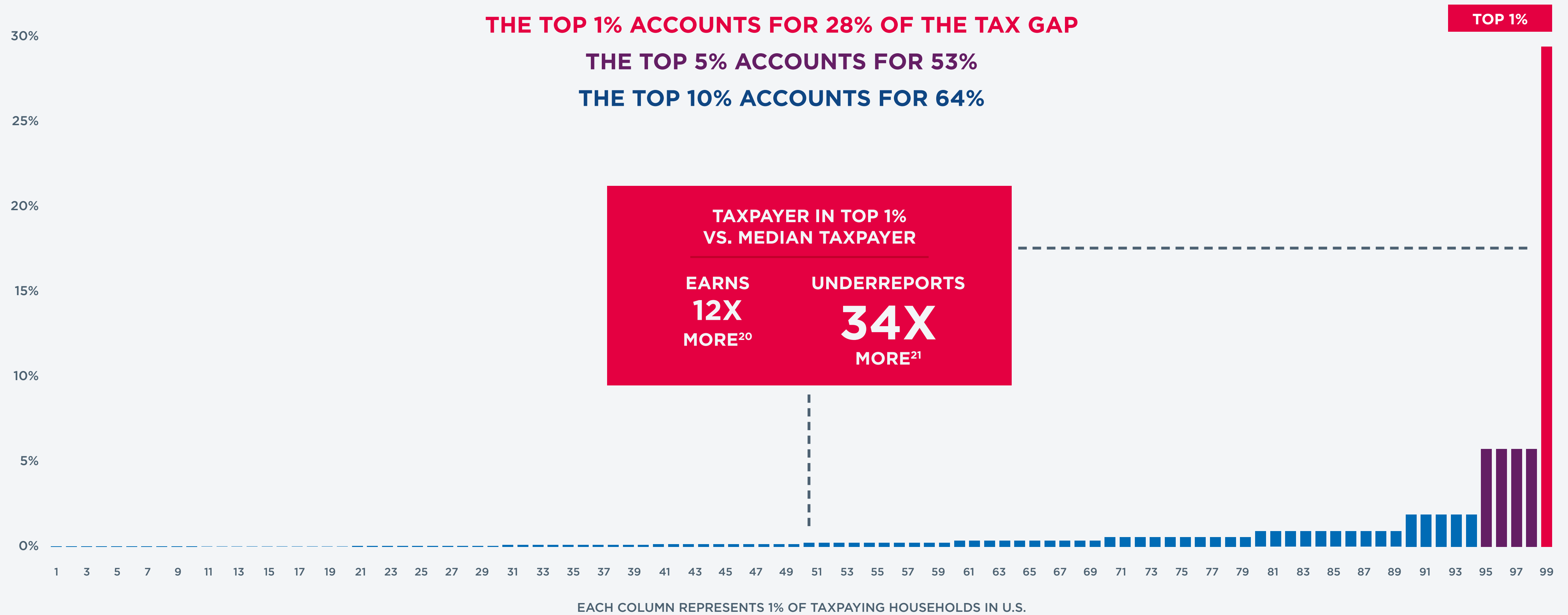
THE ANNUAL TAX GAP COMPARED TO THE COSTS OF CRITICAL LONG-TERM INVESTMENTS



# THE DISTRIBUTION OF THE TAX GAP SHOULD INFURIATE YOU

## TAX GAP DISTRIBUTION BY INCOME PERCENTILE<sup>19</sup>

**THE TOP 1% ACCOUNTS FOR 28% OF THE TAX GAP**  
**THE TOP 5% ACCOUNTS FOR 53%**  
**THE TOP 10% ACCOUNTS FOR 64%**



# HOW BUDGET CUTS HOBBLING IRS ENFORCEMENT AND CUSTOMER SERVICE

## CONGRESS CUT 18% OF THE IRS BUDGET FROM 2010-2018, WHICH HURT HIRING AND TRAINING

Fewer agents: From 2010 to 2018, the IRS lost 1 in 3 enforcement employees.<sup>22</sup>



The IRS has roughly the same number of employees today as it did in 1970 - even though the population has grown by 62%.

**1970**

1 IRS EMPLOYEE PER 2,961 PEOPLE<sup>23</sup>

**2020**

1 IRS EMPLOYEE PER 4,368 PEOPLE<sup>24</sup>

## THE IRS CANNOT KEEP UP WITH ADVANCED EVASION TECHNIQUES

Understanding the interrelated business activities of partnerships and other complex businesses makes auditing them expensive and time-intensive. As a result, very few partnership returns are audited.



AVERAGE PARTNERSHIP AUDIT<sup>26</sup>



AVERAGE ROUTINE FIELD AUDIT<sup>27</sup>

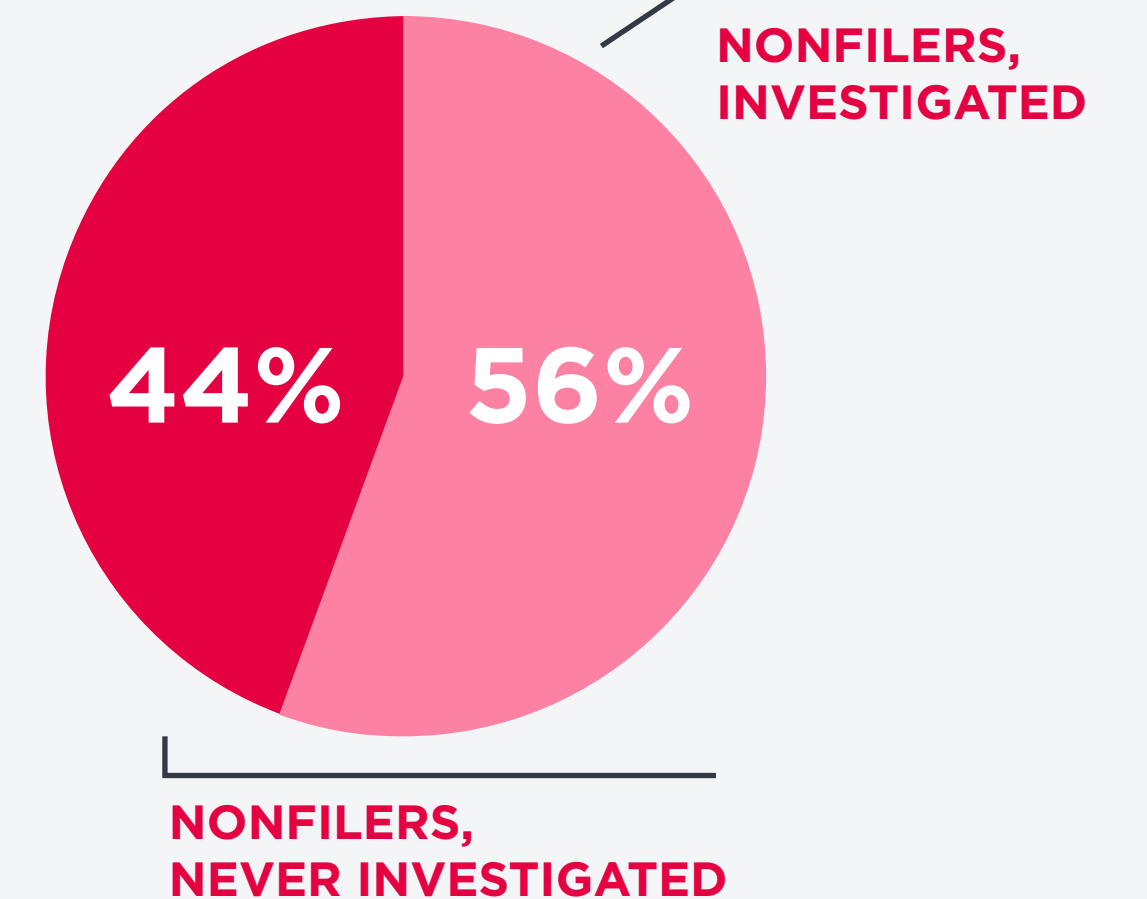


NOTE: EACH DAY IS 24 HOURS OF AUDIT TIME

## THE IRS FAILED TO PURSUE NEARLY HALF OF HIGH-INCOME NONFILERS - THE LOWEST HANGING FRUIT

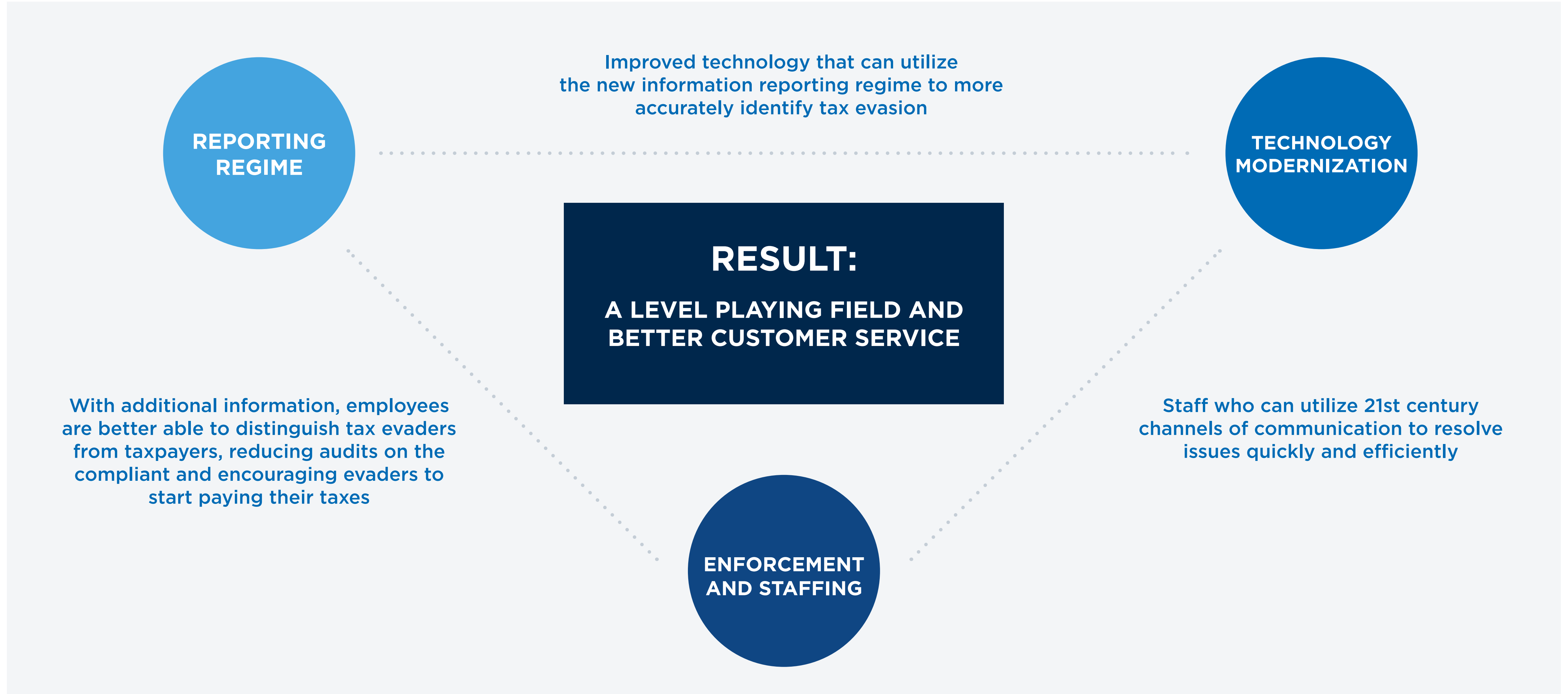
900,000 high-income individuals never filed a tax return. Due to a lack of resources, 400,000 (44%) of these nonfilers were never even investigated.<sup>28</sup>

TREASURY INSPECTOR GENERAL'S REPORT, DATA ON NONFILERS (2014-2016)





# ALL THREE REFORMS WILL WORK IN TANDEM TO IMPROVE SERVICE AND INCREASE VOLUNTARY COMPLIANCE



# PART ONE: CREATE THIRD-PARTY REPORTING FOR OPAQUE BUSINESS INCOME

## VERIFICATION EXISTS FOR MOST INCOME ALREADY

Your employer verifies your wages.

Your bank verifies your interest earnings.

Your broker verifies your earnings on your 401(k).

Social Security verifies your benefits.

Companies like eBay verify what you earn using their services.

But no one verifies business income.

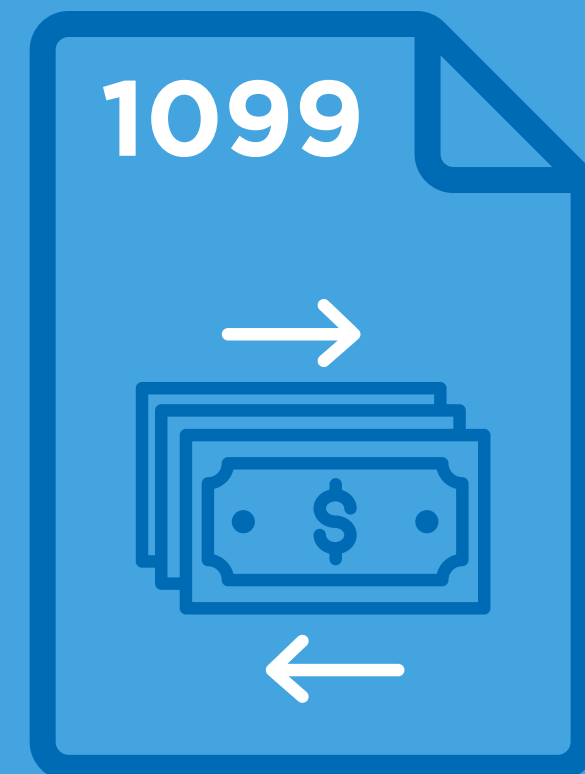
Which is why more than half of all business income is not reported to the IRS.

## REQUIRE FINANCIAL INSTITUTIONS TO VERIFY INFLOW/OUTFLOW DATA ON BUSINESS ACCOUNTS TO THE IRS

They already collect this data.

They already send reports — like interest on 1099s — on these accounts to the IRS.

They collectively produce 3.3 billion of these forms/year.



## THE BURDEN OF THE NEW REPORTING REGIME WILL NOT FALL ON TAXPAYERS

Taxpayers do not collect or share any additional information themselves. Their financial institutions do all the work.

**\$0**

## THE PAYOFF IS HUGE

Unreported business income becomes more transparent — just like wages and other income. In 10 years, the Treasury estimates the proposal will result in an additional \$460 billion.<sup>29</sup>

Ultra-high earners disclose more income, pay their fair share.

IRS audits are more targeted and efficient — and compliant taxpayers face lower audit risk.



## PART TWO: MODERNIZE IRS SYSTEMS

### DEPLOYING NEW ANALYTICAL TECHNIQUES WILL ULTIMATELY LEAD TO FEWER AUDITS

When the IRS audits someone that has paid what they owe, the result is a “no change” audit. The rate of no change audits ranges from an average of 11% for individual taxpayers to 50% for some corporations.<sup>30</sup>

By using better technology and machine learning, the IRS can conduct a more informed audit process that reduces the burden on compliant taxpayers.

“

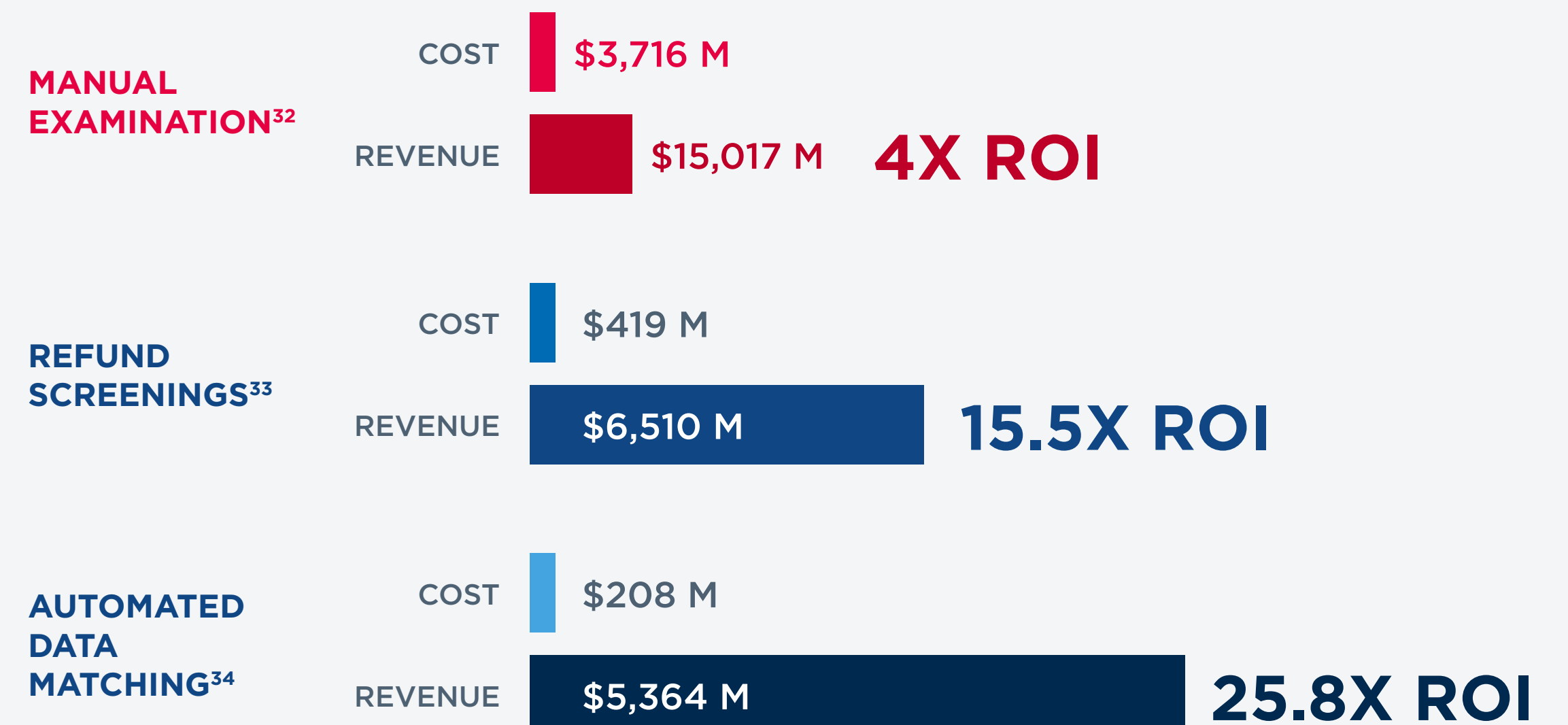
The IRS is going to be much smarter with respect to the way that it does its enforcement activities in ways that are going to decrease taxpayer burdens quite meaningfully.

”

- NATASHA SARIN  
DEPUTY ASSISTANT SECRETARY FOR ECONOMIC POLICY,  
U.S. DEPARTMENT OF TREASURY<sup>31</sup>

### INVESTMENTS IN BETTER TECHNOLOGY MORE THAN PAY FOR THEMSELVES

Technology that can utilize more information would increase productivity and more effectively target real evasion. Already, programs that the IRS has created to help automate the process have yielded higher returns on investment than manual audits.

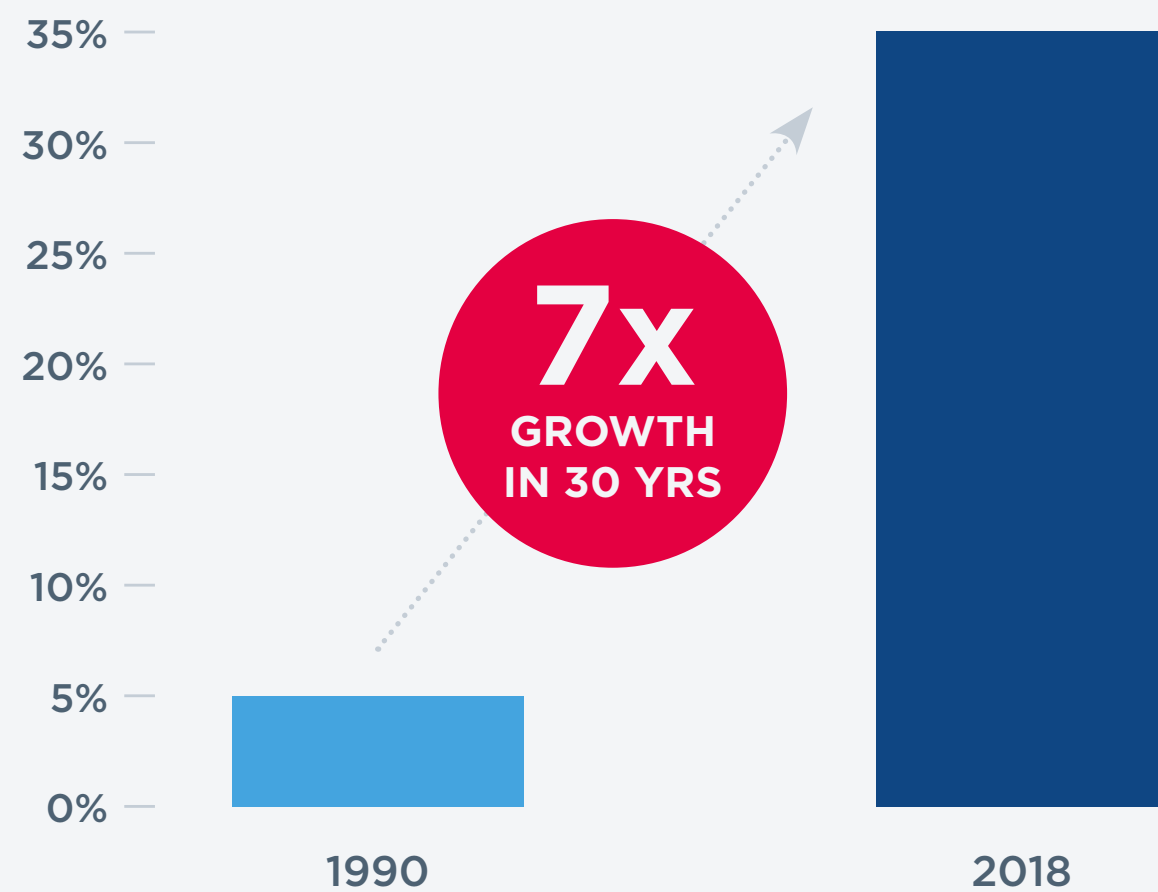


# PART THREE: REPAIR, RESTAFF, AND RETRAIN THE IRS

## HIRE SPECIALIZED STAFF TO AUDIT HIGH-INCOME BUSINESSES WITH OPAQUE INCOME

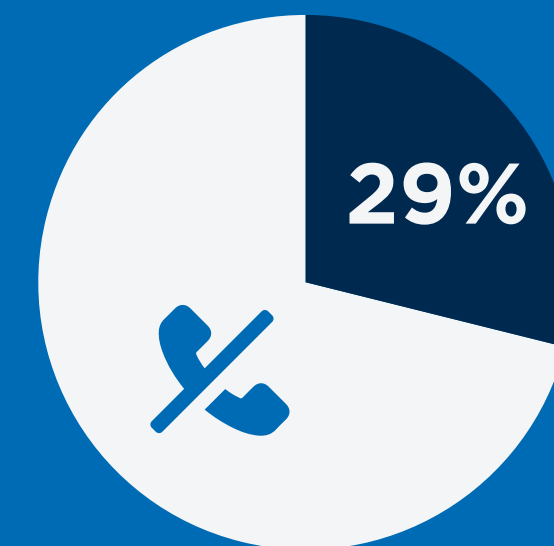
As the number of partnerships and sophisticated businesses grow, the IRS needs more specialized enforcement staff to keep up. With more specialized staff and better technology, the IRS can more effectively examine the returns of corporations, partnerships, and global high-wealth individuals - which are the most time consuming to audit but contribute disproportionately to the tax gap.

PARTNERSHIP INCOME AS A SHARE OF TOTAL INCOME<sup>35</sup>



## IMPROVE TAXPAYER SERVICES

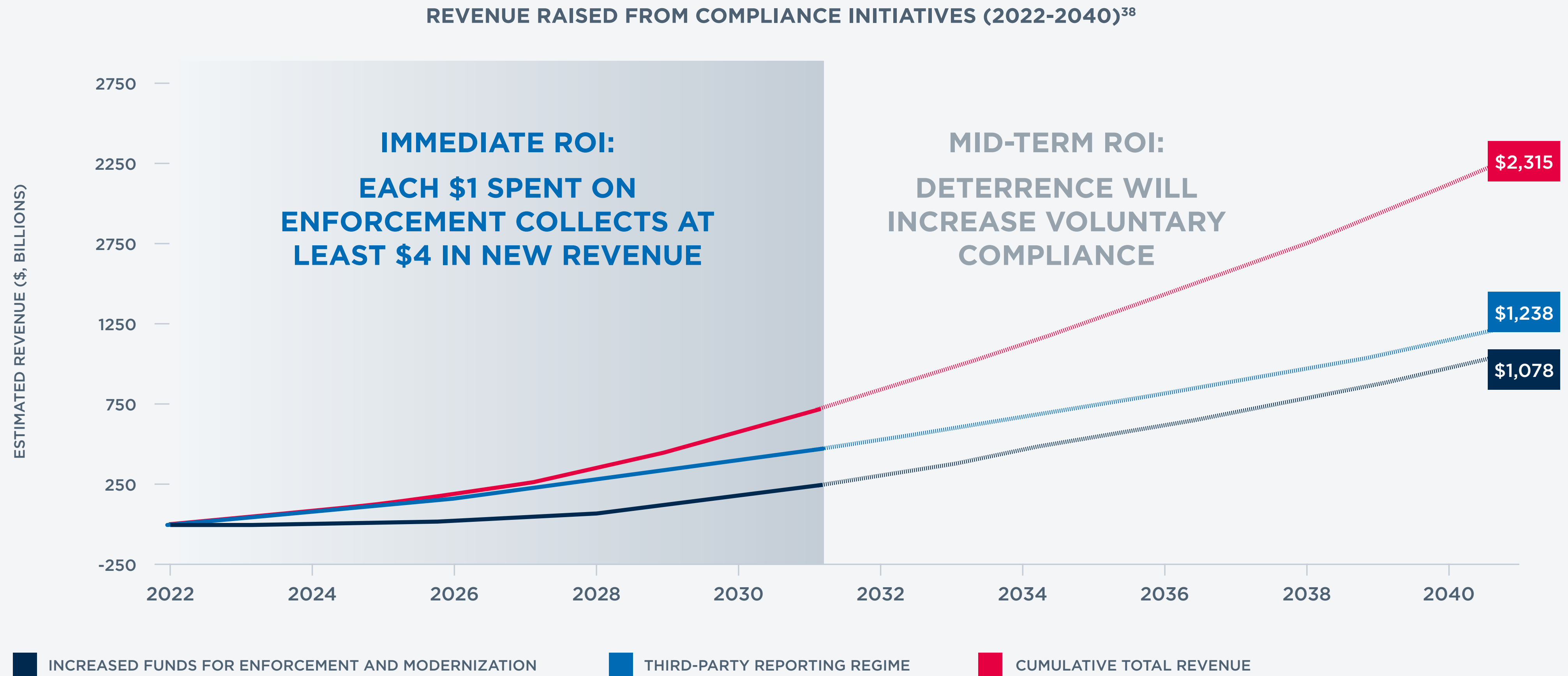
To improve taxpayer services, the IRS must hire more dedicated customer service representatives and implement new technology that makes communication easier and faster. Taxpayers should not have to spend time and money to resolve issues that arise from mistakes or misunderstandings.



THE IRS WAS ABLE TO ANSWER ONLY 29% OF THE 100 MILLION CALLS RECEIVED IN 2019.<sup>36</sup>

# THE ROI FROM IRS MODERNIZATION IS MASSIVE AND WILL GROW OVER TIME

As part of the American Families Plan, the White House proposed increasing the IRS budget by 6% annually over the next ten years - which would generate \$700 billion in the first decade, and \$1.6 trillion in the next decade.<sup>37</sup>



# REFERENCES

1. “The American Families Tax Plan Compliance Agenda.” The U.S. Department of the Treasury. May 2021. <https://home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf>.
2. DeBacker, Jason, Bradley Heim, Anh Tran, and Alexander Yuskavage. “Tax Noncompliance and Measures of Income Inequality.” Tax Notes Federal. February 17, 2020. <https://www.taxnotes.com/tax-notes-federal/compliance/tax-noncompliance-and-measures-income-inequality/2020/02/17/2c3y5>
3. Hanlon, Seth. “Unrigging the Economy Will Require Enforcing the Tax Laws.” Center for American Progress. March 12, 2020. <https://www.americanprogress.org/issues/economy/reports/2020/03/12/481539/unrigging-economy-will-require-enforcing-tax-laws/>.
4. “Internal Revenue Service Data Book, 2020.” IRS. June 2021. <https://www.irs.gov/pub/irs-pdf/p55b.pdf>.
5. Shrink the Tax Gap. <https://shrinkthetaxgap.com/>
6. “Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates.” IRS. October 2020. <https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-rates-and-tax-shares>.
7. DeBacker et. al. “Tax Noncompliance.” February 17, 2020.
8. Ibid.
9. Ibid.
10. “The American Families Tax Plan Compliance Agenda.” The U.S. Department of the Treasury. May 2021.
11. Ibid.
12. Ibid.
13. “Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates.” IRS. October 2020. <https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-rates-and-tax-shares>.
14. Ibid.
15. “FACT SHEET: The American Jobs Plan.” The White House. March 31, 2021. <https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/>.
16. “FACT SHEET: The American Families Plan.” The White House. April 28, 2021. <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/>.
17. “FACT SHEET: The American Jobs Plan.” The White House. March 31, 2021.
18. “FACT SHEET: The American Families Plan.” The White House. April 28, 2021.
19. DeBacker et. al. “Tax Noncompliance.” February 17, 2020.
20. “Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates.” IRS. October 2020.
21. DeBacker et. al. “Tax Noncompliance.” February 17, 2020.
22. Hanlon, Seth. “Unrigging the Economy Will Require Enforcing the Tax Laws.” March 12, 2020.
23. “1970 Annual Report.” Pg 79. IRS. Accessed July 2021. <https://www.irs.gov/pub/irs-soi/70dbfullar.pdf>.
24. “Personnel Summary, by Employment Status, Budget Activity, and Selected Personnel Type, Fiscal Years 2019 and 2020.” IRS. Last updated June 24, 2021. <https://www.irs.gov/statistics/irs-budget-and-workforce>. (Table 32)
25. “Table 17a: Examination Coverage and Recommended Additional Tax After Examination, by Type and Size of Return,” IRS. Accessed July 2021. <https://www.irs.gov/statistics/soi-tax-stats-examination-coverage-and-recommended-additional-tax-after-examination-by-type-and-size-of-return-tax-years-2010-2018-irs-data-book-table-17>.
26. “The American Families Tax Plan Compliance Agenda.” The U.S. Department of the Treasury. May 2021.
27. Ibid.
28. Ibid.
29. Ibid.
30. “Table 17b. Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2019,” IRS. Accessed July 2021. <https://www.irs.gov/statistics/soi-tax-stats-examination-coverage-recommended-and-average-recommended-additional-tax-after-examination-irs-data-book-table-17b>.
31. Sarin, Natasha. “Briefing: IRS modernization and tax compliance provisions of the American Families Plan.” Business Forward. June 9, 2021. [https://www.podomatic.com/podcasts/businessfwd/episodes/2021-06-09T13\\_39\\_29-07\\_00](https://www.podomatic.com/podcasts/businessfwd/episodes/2021-06-09T13_39_29-07_00).
32. U.S. Congress, Senate. Committee on Finance, Subcommittee on Taxation and IRS Oversight. Testimony of Charles O. Rossotti, Former IRS Commissioner (1997-2002). 117th Cong., 1st sess., May 11, 2021. <https://www.finance.senate.gov/imo/media/doc/SFC%20written%20submission%20final05082021.pdf>.
33. Ibid.
34. Ibid.
35. “The American Families Tax Plan Compliance Agenda.” The U.S. Department of the Treasury. May 2021.
36. Sell, Sarah Skidmore. “Underfunded IRS struggles to send refunds, answer calls.” AP News. January 8, 2021. <https://apnews.com/article/us-news-business-laws-ap-top-news-aad7a3baaf338272c157bae07668ed43>.
37. “The American Families Tax Plan Compliance Agenda.” The U.S. Department of the Treasury. May 2021.
38. Ibid.

[INFO@BUSINESSFWD.ORG](mailto:INFO@BUSINESSFWD.ORG)

---

[BUSINESSFORWARD.ORG](http://BUSINESSFORWARD.ORG)

---

1155 CONNECTICUT AVENUE NW  
SUITE 1000  
WASHINGTON, D.C. 20036

---

202.861.1270

 **BUSINESSFORWARD**  
FOUNDATION