

# Taxpayers F.I.R.S.T.

*A Project of National Taxpayers Union Foundation*

## **Minding the Gap: Recommendations for Assessing, Addressing, and Ameliorating the Tax Gap**

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Congress passed the Inflation Reduction Act (IRA) in 2022, which included just under \$80 billion in additional funding for the Internal Revenue Service (IRS) over a ten-year period, increasing its funding by over 50 percent.<sup>1</sup> Though part of this total was later rescinded under the Fiscal Responsibility Act of 2023, the IRS remains set to benefit from a significant boost to its funding over the next decade.

But while additional funding should expand the IRS's capabilities, the IRA left things fairly open-ended as to how exactly the IRS should direct these new resources and what metrics it should be focusing on. In order to fill this gap and provide the IRS and policymakers with expert advice on reform and modernization, the National Taxpayers Union Foundation (NTUF) launched its Taxpayers for IRS Transformation (Taxpayers FIRST) project.

At the core of the Taxpayers FIRST project is the convening of an advisory board made up of former IRS officials, academics, practitioners, accountants, and policy experts. These advisory board members have diverse views and backgrounds, but are united in the shared goal of ensuring that the taxpayer dollars entrusted to the IRS help make it more efficient, effective, and accountable.

Informed by the discussions of the Taxpayers FIRST Advisory Board, NTUF will publish four reports covering areas IRA funding was meant to address. The ideas in these papers do not necessarily reflect the specific views of any single member; rather, they are synthesized views after critical debate, discussion, and review by the Advisory Board.

The first installment in this series looks at an issue that featured prominently in debates leading up to the passage of the IRA: the tax gap.

### **Background: The Tax Gap and its Shortcomings**

The tax gap is the difference between the tax revenues collected by the IRS and the amount taxpayers owed under the law and should have paid. Once a data point mainly of interest to tax administrators and tax policy wonks, this figure has taken on far greater relevance of late. The size of the tax gap is important because it reflects uncollected revenues resulting from non-filing, underreported income, and underpayment of taxes, and is often used as one measure of the fairness and efficiency of the tax system.

Closing the tax gap can be an important element of a program of deficit reduction. The tax gap represents taxes that are already due, not new obligations, and taxes that go uncollected either contribute to the deficit or push greater obligations onto compliant taxpayers.

The IRS periodically releases updated estimates of the size of the tax gap. The “gross tax gap” metric — the figure that reflects the difference between taxes owed in a year and the amount of taxes paid on time — often receives greater attention. But its counterpart, the “net tax gap,” which takes into account late payments and enforcement efforts, is generally more instructive. Under the latest IRS tax gap report, which covers up through tax year 2021, the net tax gap has risen to \$625 billion. Table 1 shows the change over time of the size of the net tax gap.

While the net tax gap figure, or amounts uncollected after enforcement, is a far more relevant figure, the IRS tends to highlight the “gross tax gap” metric in its publications, leading journalists and policymakers to do the same.

Media coverage of these figures has tended to focus on the top-line numbers in these reports, perhaps to the detriment of public understanding of what reports on the size of the tax gap actually tell us. Encouraging better reporting of the top-line number, as well as the methodology behind it, can help taxpayers and policymakers draw more accurate conclusions from the data.

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<sup>1</sup> Congressional Research Service, “IRS-Related Funding in the Inflation Reduction Act,” CRS-IN11977, Updated October 20, 2022, <https://crsreports.congress.gov/product/pdf/IN/IN11977>.

**Table 1. IRS Tax Gap Reports Published Since 2007: Gross and Net Tax Gap**

Publication Year	Tax Years Included in the Report	Gross Tax Gap (in Billions)	Net Tax Gap (in Billions)
<a href="#">2007</a>	2001	\$345	\$290
<a href="#">2012</a>	2006	\$450	\$385
<a href="#">2016</a>	2008-2010	\$458	\$406
<a href="#">2019</a>	2011-2013	\$441	\$381
<a href="#">2022</a>	2014-2016	\$496	\$428
<a href="#">2022</a>	2017-2019	\$540	\$470
<a href="#">2023</a>	2020	\$601	\$539
<a href="#">2023</a>	2021	\$688	\$625

For example, IRS tax gap estimates are grounded in audit data, but rely on assumptions and extrapolations. The tax gap does not represent revenue the IRS *knows* is not being collected and lacks the resources to acquire; it is revenue the IRS *believes* is owed by taxpayers. That by no means suggests that tax gap reports are worthless, but the significant confidence interval built into these reports is often ignored in public discussions of the top-line number.

Some other assumptions have likewise been baked into public discourse over the tax gap. One such assumption is that the existence of the tax gap is fundamentally a failing of enforcement, that unpaid taxes are entirely attributable to intentional “tax cheats,” and that expanded enforcement is the only tool available to policymakers to narrow the gap.

While there are filers who intentionally underreport their taxable income, there are also many taxpayers who make mistakes or do not realize that certain income of theirs may be taxable. Enforcement is the appropriate tool to address intentional tax evasion, but can be unhelpful or even harmful for taxpayers left confused by our labyrinthine tax code.

Another popular misconception is that the tax gap is a pot of revenue waiting to be claimed, and can feasibly be eliminated. The experiences of other countries suggest that a zeroed-out tax gap, or even anything close, is not a realistic goal, and enforcement efforts aimed at such a goal eventually yield diminishing returns. No country has succeeded in fully eliminating their tax gaps, while the Congressional Budget Office (CBO) estimates<sup>2</sup> show decreasing marginal returns on increased enforcement spending.

What’s more, debate over projected revenue impacts of different proposals to close the tax gap often neglects to factor in the increased cost of compliance taxpayers incur under more aggressive enforcement efforts. While some revenue can doubtlessly be clawed back via some of the methods outlined in this paper, policymakers should recognize that even the most energetic enforcement efforts may not obtain the projected collections upon which public officials are depending.

<sup>2</sup> Congressional Budget Office, “Trends in the Internal Revenue Service’s Funding and Enforcement,” July 2020, <https://www.cbo.gov/publication/56467>.

## What the Tax Gap Really Tells Us

Up until a few years ago, the most recently released tax gap report covered 2014-2016, when the estimated net tax gap was \$428 billion. These estimates are based on administrative data, survey results, and random taxpayer audits. Recently, the IRS has released a flurry of reports to provide data through 2021. Tax gap data beyond 2016 represents IRS projections using compliance levels estimated with the aforementioned data in prior years as well as the amount of tax reported for the year in question. According to these projections, the size of the net tax gap has increased substantially since a decade ago.

The table above shows the tax gap estimates included in IRS reports published since 2007. In some of its reports, the IRS has produced a tax gap estimate as an average over a three year period. Its most recent report published in 2023 breaks that trend and shows the annual estimates for 2020 and 2021, respectively.<sup>3</sup>

### The Tax Gap in Context: Share of Revenues

As Tables 1 and 2 show, most of the growth in the size of the tax gap is correlated with economic growth and increases in revenue collection. As a percentage of revenue collected, the net tax gap has remained fairly steady around 15 percent. In particular, even as the net tax gap has increased significantly from \$381 billion to \$625 billion since 2011-2013, this figure as a percentage of total revenue collected has stayed relatively constant.

**Table 2. IRS Tax Gap As a Share of Tax Revenues Collected**

Publication Year	Tax Years Included in the Report	Net Tax Gap as a % of Revenue
<a href="#">2007</a>	2001	14.6
<a href="#">2012</a>	2006	16
<a href="#">2016</a>	2008-2010	17.9
<a href="#">2019</a>	2011-2013	15.2
<a href="#">2022</a>	2014-2016	13.5
<a href="#">2022</a>	2017-2019	14.3
<a href="#">2023</a>	2020	15.8
<a href="#">2023</a>	2021	15.4

On the one hand, this suggests that the tax gap is not a *growing* problem but rather a constant drawback of a growing tax collection apparatus. On the other hand, it does mean that efforts to address the tax gap could yield proportionally more revenue than they might have in the past.

### The Tax Gap in Context: Compliance Rates

Table 3 shows compliance rates reported in each of the IRS's projections. There are some slight variations, but in general the data shows a high rate of compliance, with an average of 86 percent over all of the reports.

<sup>3</sup> Four additional reports that the IRS published between 1988 and 1996 include tax gap estimates for tax years 1973 through 1992. "IRS: The tax gap," <https://www.irs.gov/statistics/irs-the-tax-gap>.

**Table 3. IRS Tax Gap Reports Published Since 2007: Net Compliance Rate**

Publication Year	Tax Years Included in the Report	Net Compliance Rate (Percent)
<a href="#">2007</a>	2001	86.3
<a href="#">2012</a>	2006	85.5
<a href="#">2016</a>	2008-2010	83.7
<a href="#">2019</a>	2011-2013	85.8
<a href="#">2022</a>	2014-2016	87
<a href="#">2022</a>	2017-2019	87
<a href="#">2023</a>	2020	86.2
<a href="#">2023</a>	2021	86.3

## The Tax Gap in Context: International Comparison

The United States compares favorably to other countries in terms of the size of its tax gap. As the IRS itself has said, “In general, the tax gap estimates dating back decades consistently show the United States enjoys a relatively high and stable voluntary tax compliance rate.”<sup>4</sup> Indeed, studies on the topic, while in danger of comparing apples to oranges, have consistently shown that the American tax gap as a percentage of GDP is lower than its European and Organization for Economic Cooperation and Development counterparts.<sup>5</sup> The International Survey on Revenue Administration, a survey jointly administered by international agencies including the International Monetary Fund (IMF) and Organization for Economic Cooperation and Development (OECD), notes that only 20 countries measure their personal income tax gap.<sup>6</sup> Italy stands out amongst those that measure personal income tax avoidance with an estimated tax gap of 90 billion Euros in 2020,<sup>7</sup> amounting to about 4.7 percent of their GDP that year.<sup>8</sup> While larger in absolute terms, the 2020 net tax gap calculated by the IRS only amounted to 2.5% of United States GDP. Of note, it is simpler to measure and compare the value-added tax (VAT) tax gap in Europe due to consistency of application. Even so, tax avoidance remains a concern, with a compliance gap of 5.4 percent in 2021.<sup>9</sup>

Here again, the conclusion should not be that the tax gap is not a problem. Rather, the tax gap should be viewed as a drawback of tax systems worldwide that the United States is already doing a competent job of mitigating — though it could potentially do even better. Recognizing this context can remove a false sense of crisis from debates over IRS reform.

<sup>4</sup> IRS, “The Tax Gap,” 2023 <https://www.irs.gov/newsroom/the-tax-gap>.

<sup>5</sup> Chris Edwards, “U.S. Tax Gap Relatively Small,” Cato Institute: Cato at Liberty, Nov. 29, 2021, <https://www.cato.org/blog/us-tax-gap-relatively-small>.

<sup>6</sup> International Monetary Fund, “Corporate Income Tax Gap Estimation by using Bottom-Up Techniques in Selected Countries: Revenue Administration Gap Analysis Program,” 2023 <https://www.imf.org/en/Publications/TNM/Issues/2023/10/31/Corporate-Income-Tax-Gap-Estimation-by-using-Bottom-Up-Techniques-in-Selected-Countries-537786>.

<sup>7</sup> “U.S. Department of State, 2023 Investment Climate Statements: Italy,” 2023 <https://www.state.gov/reports/2023-investment-climate-statements/italy/>.

<sup>8</sup> The World Bank, “GDP (current US\$) – Italy,” last visited Feb. 21, 2023 <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=IT>.

<sup>9</sup> Cristina Enache, “Is EU VAT Compliance Actually Improving?,” Tax Foundation: Tax Policy Blog, Nov. 13, 2023 <https://taxfoundation.org/blog/eu-vat-gap-compliance/>.

## What's in the Tax Gap Estimate

The IRS breaks up its estimate of the size of the tax gap into components and types of noncompliance. The components are individual income taxes, corporate income taxes, employment taxes, and estate taxes. Table 4 shows the breakdown by component for tax year 2021.

**Table 4. Components of the Tax Gap, TY 2021**

Component	Size of Net Tax Gap	% of Net Tax Gap
Individual Income Tax	\$475 billion	76%
Corporate Income Tax	\$37 billion	5.90%
Employment Tax	\$112 billion	17.90%
Estate Tax	\$1 billion	0.20%
<b>Total</b>	<b>\$625 billion</b>	<b>100%</b>

The types of noncompliance are nonfiling, underreporting, and underpayment. Unfortunately, these are presented as a percentage of the less helpful gross tax gap figure, and the impact of enforcement efforts and late payments on each component is not illustrated. Table 5 shows the portion of the gross tax gap attributable to each type of noncompliance.

**Table 5. Types of Noncompliance, TY 2021**

Type of Noncompliance	Size of Gross Tax Gap	% of Gross Tax Gap
Nonfiling	\$77 billion	11.20%
Underreporting	\$542 billion	78.80%
Underpayment	\$68 billion	9.90%
<b>Total</b>	<b>\$688 billion</b>	<b>100%</b>

For underreporting, the components of the tax gap are further broken down into subcomponents for the individual income tax, corporate income tax, and employment components (the estate tax component does not have subcomponents), though again only as a portion of the gross tax gap, not the net tax gap.

## The IRS' Methodology for Calculating the Tax Gap

The IRS began calculating the tax gap in 1979. The Congressional Research Service (CRS) notes that for the nearly the first decade of this process:

The data came from comprehensive in-person audits by IRS examination officers of random samples of individual, corporate, and employment tax returns. Many audited taxpayers found them burdensome, as they were required to provide supporting documents for every tax return line item.<sup>10</sup>

In 2000, the IRS adopted the compliance estimating method called the National Reporting Program, which is still in use today by the IRS's Office of Research, Applied Analytics and Statistics (RAAS). In general, this relies on a random sample of roughly 13,000 tax returns that are believed to be representative of the whole filing population.

## Lag in the Data Underlying the Estimates

The IRS refers to its recent estimates as projections. This is because the tax gap figure calculated in these reports are based on the compliance behavior estimated from the most recent set of completed audits. Due to amended returns and lengthy audits, it takes a while for each tax year's data to be finalized. The IRS then can analyze the results of the tax years and use that to project tax estimates in later years based on that data.

One interesting trend in the tax gap data in Table 1 above is that even as the amount of the tax gap has increased, the difference between the gross and net gap remains between \$55 billion and \$75 billion. This is likely a product of extrapolating the same old audit data while using the same enforcement tools and methods.

This lag in the data presents a problem because it can assume that compliance behavior has remained the same, without accounting for changes in economic activity, or recent tax policy or administrative reforms that could impact compliance. For example, the IRS is projecting behavior in the aftermath of the Tax Cuts and Jobs Act as well as multiple pandemic relief tax credits based on audit data from when neither of these circumstances existed.

The IRS is making an effort to address the lag in the data and to improve the timeliness of the tax gap report. For example, in its tax year 2020-2021 release the IRS notes:

To address this issue, the current release includes tax gap projections for TY 2020 and 2021 as a bridge between the competing priorities of the need for more contemporaneous tax gap estimates and having tax gap estimates based on compliance data for the time frame of the estimates.<sup>11</sup>

This most recent tax gap release marks the first time in several years that the IRS has reported a tax gap for a single year, rather than averaging data over several previous years. For example, the 2022 release included an average tax gap figure over the 2017-2019 period. While the IRS's efforts to increase the timeliness of its reports is commendable, concerns regarding the comprehensiveness and accuracy remain. The methodology still rests on assumptions of compliance behavior from previous tax years.

## Sources of Uncertainty and Data Limitations

The reported tax gap figure is based on calculations of the various components in the analysis. The most recent report includes eight components, each of which have their own sources of data, methodologies, and different timing regarding the availability of the data. The IRS notes on the methodology:

<sup>10</sup> Congressional Research Service, "Federal Tax Gap: Size, Contributing Factors, and the Debate over Reducing It," CRS-IF11887, Updated October 30, 2023 <https://crsreports.congress.gov/product/pdf/IF/IF11887>.

<sup>11</sup> IRS, "Federal Tax Compliance Research: Tax Gap Projections for Tax Years 2020 and 2021," Publication 5869, Updated Oct. 2023 <https://www.irs.gov/pub/irs-pdf/p5869.pdf>.

For example, the projections of the underreporting tax gap generally assume that compliance behavior has not changed from the [Tax Year] 2014–2016 time frame and that the tax gap grew at the same rate as the growth in reported tax. Conversely, the individual nonfiling tax gap projections are based on analysis of IRS administrative data. The projections will be annually updated as additional compliance data become available and improvements are made to the methodologies.<sup>12</sup>

The IRS could improve transparency regarding the key factors used in its methodologies. Generally, statistical analyses of this nature include a consideration of error rates or indicate a confidence interval. But the IRS notes:

Because multiple methods are used to estimate different subcomponents of the tax gap and then are projected into future tax years, no standard errors are reported.

The IRS could thread this needle by providing confidence intervals for each subcomponent. Policymakers could then have a better understanding of what estimates are to be treated as more precise.

The IRS's report provides some basic descriptions on the various methodologies used to calculate the various components of the tax gap. However, the information provided along with those summary tables does not include a reporting of the standard error rates for those components. The IRS does at least discuss some points of uncertainty in the data, including sampling errors, measurement errors, estimation errors, coverage errors, and projection errors. A discussion of the limitations of the data is generally included at the end of the reports and press releases. For example, the press release for the 2023 tax gap report concludes:

The projections cannot fully represent noncompliance in some components of the tax system including offshore activities, issues involving digital assets and cryptocurrency as well as corporate income tax, income from flow-through entities and illegal activities because data are lacking. ... For noncompliance associated with digital assets and other emerging issues, it takes time to develop the expertise to uncover associated noncompliance and for examinations to be completed that can be used to measure the extent of that noncompliance.<sup>13</sup>

The Treasury Inspector General for Tax Administration (TIGTA) also reports that there are areas of limitation that are not discussed within tax gap estimates, including certain types of taxpayers that are excluded from some estimates but not identified as such. TIGTA also notes that the IRS should provide more detailed information regarding actions taken to improve its methodology and ability to project additional areas of noncompliance.<sup>14</sup> For example, the Congressional Research Service noted recently that:

In a March 2023 report, the Treasury Inspector General for Tax Administration found that the IRS does not include estimates of all sources of taxpayer noncompliance in its tax gap estimates. For instance, in estimating income underreporting, the IRS excludes excise taxes; estate and trust taxes; unrelated business income taxes; some employment taxes; subchapter S corporate income; and individual income taxes for U.S. taxpayers with foreign addresses. It is unclear how much larger the income underreporting estimate would be if those sources were included.<sup>15</sup>

<sup>12</sup> IRS, "Federal Tax Compliance Research: Tax Gap Projections for Tax Years 2020 and 2021," Publication 5869, Updated Oct. 2023 <https://www.irs.gov/pub/irs-pdf/p5869.pdf>.

<sup>13</sup> IRS, "IRS updates tax gap projections for 2020, 2021; projected annual gap rises to \$688 billion," Oct. 12, 2023 <https://www.irs.gov/newsroom/irs-updates-tax-gap-projections-for-2020-2021-projected-annual-gap-rises-to-688-billion>.

<sup>14</sup> Treasury Inspector General for Tax Administration, "Actions Are Needed to Improve the Completeness, Development, and Review of IRS Tax Gap Estimates," Mar. 23, 2023 <https://www.tigta.gov/sites/default/files/reports/2023-03/202310016fr.pdf>.

<sup>15</sup> Congressional Research Service, "Federal Tax Gap: Size, Contributing Factors, and the Debate over Reducing It," CRS-IF11887, Updated October 30, 2023 <https://crsreports.congress.gov/product/pdf/IF/IF11887>.



TIGTA has also raised concerns that the IRS does not have a good process for documenting the processes and policies used to project the tax gap. RAAS relies on the experience of its long-time staffers to produce the analyses. This raises the question of preserving institutional knowledge during inevitable turnover and the ability to adhere to, as well as replicate, the methods used.

## Ideas for Action

Informed by the discussions among the experts on the Taxpayers FIRST Advisory Board, NTUF offers the following recommendations for more efficient use of the increased funds provided to the IRS under the Inflation Reduction Act:

**Report the tax gap data in context.** The top line dollar figure highlighted in IRS’ press releases and often echoed throughout new coverage tends to be the gross tax gap estimate. Given the existing enforcement efforts and late payments, which can result from initial mistakes, misunderstandings, disputes with the IRS regarding interpretation of tax provisions, or life events and emergencies that happen, the net tax gap is of more significance.

The IRS should also highlight the “net tax gap” figure, not the “gross tax gap” figure as the most relevant metric. It should also break out the impact of enforcement and late payments on each subcomponent of the tax gap, as well as the type of noncompliance. Doing so would help those inside and outside the Service to better target enforcement resources on specific noncompliance problems.

The tax gap will appear to grow from year to year simply due to an expanding economy or inflation. The IRS should provide context by also presenting the tax gap figure as a share of all revenues received. This would provide a better understanding of the total tax gap figure.

**Formalize and standardize the methodology and processes used to project the tax gap.** The ability to work with outside experts and stakeholders to improve the methodologies used to estimate the components currently included in the tax gap or to help build models for estimating emergent and missing areas of noncompliance can be assisted by RAAS producing a guide to policies and processes used. TIGTA has recommended that the IRS “should develop consolidated, written policies and procedures for developing the Tax Gap to help ensure repeatability, timeliness, quality, and continuity of the Tax Gap estimates and improve oversight.<sup>16</sup> Absent this effort, policies to address the tax gap will not be as adaptable, nimble, or cost-efficient as they could be.

**Provide transparency on points of uncertainty in tax gap projections, using ranges or confidence intervals where appropriate.** TIGTA’s review last year of the IRS’s tax gap estimate raises an important concern: “... [T]he lack of clarity and transparency around the comprehensiveness of the tax gap estimates creates the potential for stakeholders to misunderstand or disregard them.”

Given the complexities and variances in the methodologies discussed, the IRS should emulate the approach implemented in recent years by the Congressional Budget Office. CBO produces detailed cost estimates and analysis of legislative proposals. Under current Director Phillip Swagel, CBO has begun emphasizing the points of uncertainty in its cost estimates directly below their summary outlay and revenue estimate tables. For example, the first page of CBO’s recent score of H.R. 7024, Tax Relief for American Families and Workers Act of 2024, includes summary budget estimates and notes that areas of significant uncertainty include “anticipating changes in population, personal income, and business investment.”<sup>17</sup>

<sup>16</sup> Treasury Inspector General for Tax Administration, “Actions Are Needed to Improve the Completeness, Development, and Review of IRS Tax Gap Estimates,” Mar. 23, 2023 <https://www.tigta.gov/sites/default/files/reports/2023-03/202310016fr.pdf>.

<sup>17</sup> Congressional Budget Office, “Cost Estimate: H.R. 7024, Tax Relief for American Families and Workers Act of 2024,” January 25, 2024 [https://www.cbo.gov/system/files/2024-01/hr7024\\_1.pdf](https://www.cbo.gov/system/files/2024-01/hr7024_1.pdf).

The IRS should follow suit and also provide a look behind the curtain on methodology and confidence intervals for each distinct sub-component of the tax code.

**Study how to improve the comprehensiveness of the tax gap calculation.** The IRS should seek to examine potential sources of underreporting income in emergent economic activities and areas where the IRS suspects significant noncompliance. These studies could be conducted on a rotating quarterly basis to develop or improve methodologies and data sources.

TIGTA has recommended that the IRS conduct focused studies on certain areas. For example, in 2013 TIGTA recommended a study to determine the feasibility of estimating the tax gap for offshore tax evasion.<sup>18</sup> In 2017 the Government Accountability Office recommended that the IRS conduct a similar study regarding partnerships.<sup>19</sup> RAAS did not implement those recommendations, citing competing priorities and resource constraints as the leading reasons.<sup>20</sup> With the IRA funding, resources are no longer a limiting factor, and given the priority placed on increasing enforcement and compliance, completing these studies should be on the IRS's to-do list.

Other federal agencies and the private sector could both offer insight regarding communicating consumer payment obligations which may be applicable to the IRS. For example, recent changes to student loan policies have spurred the Department of Education to regularly provide borrowers with information about their potential payment changes. Providing taxpayers with informational updates and advance notice around filings that are less commonly understood, such as quarterly estimates, could prevent noncompliance from occurring. Similarly, banks provide customers with information regarding changes to loan balances in times of rate changes, bank mergers, or other restructurings. The health care sector could also provide examples of customer interaction to ensure voluntary compliance, such as through successful enrollment for health insurance during open season.

Other current topics to consider for study include cryptocurrency, digital assets, and pass-through business income. However, the IRS should frequently be adjusting these topics of study to confront new compliance challenges.

The use of external advisors and stakeholders can be institutionalized by reconstituting and formalizing the Tax Gap Advisory Panel, which in the past has provided feedback on some of the IRS's reports. The names of the participants of the panel and its feedback on the tax gap methodologies should be made publicly available to help provide transparency and oversight with the goal of providing policymakers with more complete and more accurate estimates.

The purpose of examining the tax gap is to identify areas where there are low rates of compliance. The lag in the data undermines the effectiveness of that goal. Expertise brought in to provide feedback on current and emergent methodologies, highlighted through the recommended series of reports, can also help improve the timeliness of the IRS's tax gap estimates. Identifying and quantifying the individual components of the tax gap is ultimately more important than the top line number that the IRS highlights in its tax gap analyses, as different components of the tax code can call for different approaches in terms of improving compliance.

**Set accountable goals and metrics for addressing the tax gap.** The IRS should set clear goals for both estimating and reducing the tax gap. The goals would help focus the IRS on specific tasks towards defined objectives, and well-chosen metrics will help the IRS to measure its progress in achieving the goals. Treasury, the White House, Congress, and external stakeholders should assist the IRS in determining the proper metrics.

<sup>18</sup> Treasury Inspector General for Tax Administration, "The Internal Revenue Service Needs to Improve the Comprehensiveness, Accuracy, Reliability, and Timeliness of the Tax Gap Estimate," Report No. 2013-IE-R008, Aug. 2013 (Link no longer available to this report).

<sup>19</sup> Government Accountability Office, "Tax Gap: IRS Needs Specific Goals and Strategies for Improving Compliance," October 31, 2017 <https://www.gao.gov/products/gao-18-39>.

<sup>20</sup> Treasury Inspector General for Tax Administration, "Actions Are Needed to Improve the Completeness, Development, and Review of IRS Tax Gap Estimates," Mar. 23, 2023 <https://www.tigta.gov/sites/default/files/reports/2023-03/202310016fr.pdf>.

This process has worked in the past. A report from the Shrink the Tax Gap Program headed by former IRS Commissioner Charles Rossotti and former IRS Associate Commissioner for Business Systems Modernization Fred Forman noted how the goals set in the IRS Restructuring and Reform Act of 1998 guided the IRS's efforts to encourage and increase the use of electronic filing.<sup>21</sup> The authors advised:

Once a clear mandate and direction such as suggested above is set into law, the IRS will propose specific programs and resources to accomplish the goals, including defining appropriate milestones and metrics to indicate progress. This framework would enable both Congress and the Treasury to perform their critical oversight function.

Legislative and advisory goals could steer the IRS to increasing the comprehensiveness and quality of its tax gap estimates, and set targets to improve compliance across specified components of the tax gap. Not only would this make the IRS more accountable to oversight, it would also provide policymakers with more realistic and tangible estimates of the potential revenue impact of efforts to improve compliance than a nebulous total tax gap estimate.

Metrics should be also tailored to focus on improving taxpayer service goals and to increase the quality and breadth of information that IRS officials provide to taxpayers in help clinics around the country or on its phone assistance lines. There are currently broad areas of tax law that are deemed “out-of-scope” for taxpayer services. This means that if a taxpayer calls in asking about one of these, they are referred to the IRS website for answers. Taxpayers deserve better assistance, and improving basic services and expanding the capacity of the IRS to answer questions that taxpayers have would help improve voluntary compliance.

**Increase transparency on enforcement methods and tools.** Nearly two months after the deadline set by Treasury Secretary Janet Yellen, the IRS finally submitted its Strategic Operating Plan describing how it would use the additional funding under the IRA.<sup>22</sup> While this plan laid out what general categories of IRS operations would receive how much funding and vague success conditions, it remained light on specifics. For purposes of enforcement, most descriptions of what would constitute success for each initiative were either not quantifiable or focused on secondary goals such as audit coverage.

In its forthcoming Fiscal Year 2025 budget justification, and in follow-up reports tracking progress in achieving the goals laid out in the Operating Plan, the IRS should enhance accountability by providing a more detailed look under the hood on how it intends to use its new resources to close the tax gap and what kind of realistic results it expects these expanded efforts to achieve. In cases where the IRS intends to investigate and employ new and emergent technologies, it should make clear exactly how and where it intends to do so.

**Quantify benefits of improved taxpayer services and taxpayer knowledge in boosting compliance.** The IRS, CBO, and the Joint Committee on Taxation are able to estimate the amount of increased revenues that expanded enforcement efforts can render. For example, CBO estimated that expanding reporting requirements for Form 1099-K, the tax form for individuals who sell items online and use third-party payment vendors like eBay or Venmo to process the transactions, would boost tax revenues by \$442 million over ten years.<sup>23</sup> The threshold to issue a 1099-K for these individuals was previously 200 transactions and \$20,000 of gross transactions but has been changed to a threshold of \$600 of gross transactions.

<sup>21</sup> Shrink the Tax Gap, Shrink the Tax Gap (STTG) Program Goals, Metrics, Taxpayer Rights and Oversight, May 4, 2021 <https://shrinkthetaxgap.com/goals-metrics/>.

<sup>22</sup> IRS, “Internal Revenue Service Inflation Reduction Act Strategic Operating Plan FY 2023 – 2031,” <https://www.irs.gov/pub/irs-pdf/p3744.pdf>.

<sup>23</sup> Congressional Budget Office, “Estimated Budgetary Effects of H.R. 1319, American Rescue Plan Act of 2021,” Mar. 10, 2021 <https://www.cbo.gov/publication/57056>.

However, less precise are the estimates of how a particular change in tax law will increase compliance burdens on taxpayers. Again using the Form 1099-K example, the IRS in 2021 estimated that 16 million taxpayers would receive Forms 1099-K, only slightly more than before the change. But by 2023, the IRS revised this estimate to a far higher 44 million taxpayers — an amount that may still be a conservative estimate.<sup>24</sup> In 2023, the IRS extended the deadline a further year, acknowledging that some taxpayers receiving the form might believe that the full amount reported by the payment vendors on the 1099-K would be taxable, something that is often not the case. The episode demonstrates how a focus on estimating potential increased revenues while neglecting the compliance impact is insufficient.

When lawmakers and the IRS consider ways to enhance compliance, they should be incentivized to find ways to do so through enhancing taxpayer services and taxpayer knowledge of tax laws as well as their obligations and rights. The IRS and the Department of the Treasury, in partnership with external stakeholders, should find ways to quantify and demonstrate through evidence the return on the dollar of services and education.

**Provide timelier and clearer guidance on tax compliance.** The IRS’s 2023 Strategic Operating Plan for how the IRA’s funding would be used states:

In coordination with the Office of Chief Counsel and the Department of the Treasury Office of Tax Policy, we will expand capacity to provide as much certainty on tax issues as possible. This will include issuing more legal guidance, interpreting the tax laws to address areas of uncertainty for all taxpayer segments, including current issues and those related to new legislation. We will emphasize early clarity—through formal or informal guidance—to address a wide array of taxpayer questions and reduce the need for subsequent enforcement actions. We will provide additional legal guidance to enable more taxpayers to meet their filing and tax obligations voluntarily, at the lowest cost. We will identify and implement new strategies to provide increased certainty for taxpayers. We will explore the best practices of other jurisdictions in providing taxpayers with early certainty in more timely ways, such as for risk stratification, safe harbors, or audit guidelines.<sup>25</sup>

Issuing pre-filing guidance on ways a taxpayer can stay on the right side of the law is a tax gap reduction strategy. Conducting community outreach and producing clearer notices to reduce taxpayer confusion can also help narrow the gap. The IRS is engaged in these activities. For example, Werfel has touted the increased number of taxpayer assistance centers and rolled out a recent effort to use clearer language in notices. But, more can be done. There are numerous tax topics that are out-of-scope for assistance to taxpayers on the phone or in walk-in assistance centers.<sup>26</sup> Enhanced outreach and education initiatives that target problem tax areas, coupled with clearer forms and guidance, will mitigate confusion, enhance compliance, and reduce the tax gap.

**Consolidate duplicate Tax Gap pages on the IRS website.** The IRS should consolidate the various pages it has on the tax gap to reduce potential confusion given the overlapping resources available at [irs.gov](https://www.irs.gov). For example, there is an IRS Newsroom page called “The Tax Gap.”<sup>27</sup> This page lists some of the prior year tax gap releases but is incomplete and out of date. A better landing page is found under the Taxpayer Research and IRS Data section called, “IRS: The tax gap.”<sup>28</sup> This page includes an archive of all of the IRS publications and research on the tax gap dating back to 1988.

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<sup>24</sup> Demian Brady, “New IRS Data Still Vastly Underestimates the Increasing 1099-K Burden on Taxpayers,” National Taxpayers Union Foundation, Oct. 3, 2023 <https://www.ntu.org/foundation/detail/new-irs-data-still-vastly-underestimates-the-increasing-1099-k-burden-on-taxpayers>.

<sup>25</sup> IRS, “Internal Revenue Service Inflation Reduction Act Strategic Operating Plan FY 2023 – 2031,” <https://www.irs.gov/pub/irs-pdf/p3744.pdf>.

<sup>26</sup> Internal Revenue Manual 21.1.1.3.2 [https://www.irs.gov/irm/part21/irm\\_21-001-001#idm139995547123632](https://www.irs.gov/irm/part21/irm_21-001-001#idm139995547123632).

<sup>27</sup> IRS, “The Tax Gap,” 2023 <https://www.irs.gov/newsroom/the-tax-gap>.

<sup>28</sup> IRS, “The tax gap,” <https://www.irs.gov/statistics/irs-the-tax-gap>.

## Conclusion

The IRA funding provided a large boost to the IRS, with a large portion of the funding dedicated to enforcement activities. With more funding to hire more enforcement personnel, the IRS should be able to boost compliance in cases where taxpayers are knowingly evading their tax liability.

Nonetheless, a better understanding of other sources of the tax gap can help inform IRS leadership, the administration, and Congress about ways to improve voluntary compliance. One key factor is the sheer complexity of the tax system. The Internal Revenue Code is over 4.1 million words long, and Congress regularly makes significant changes to tax law. Regulations and advisories from the IRS add to the flood of information.

Consequently, Americans spend over 6.5 billion hours each year to prepare and file their taxes.<sup>29</sup> A simpler, more static system would make it easier for the IRS to administer the tax laws and reduce filing burdens — as well as reduce cases of unintentional mistakes on tax returns. Information on the most common inadvertent errors and misunderstandings by taxpayers would be a useful addition to tax gap reports.

Even with the current complicated tax code, the IRS should devote more efforts to improving taxpayer services and taxpayers' knowledge of their responsibilities and rights. Both of these would contribute to boosting compliance.

NTUF extends gratitude to the following individuals who contributed their input to discussions that informed this paper. The views expressed herein do not necessarily reflect the views or positions of any individual contributor or organization associated with the contributors.

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<sup>29</sup> Demian Brady, "Tax Complexity 2024: It Takes Americans Billions of Hours to Do Their Taxes," National Taxpayers Union Foundation, April 15, 2024, <https://www.ntu.org/foundation/tax-page/all-tax-complexity-studies>

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