



Treasury Inspector General for Tax Administration

Inspections and Evaluations

Highlights

Highlights of Report Number: 2013-IE-R008 to the Internal Revenue Service, Director, Office of Research, Analysis, and Statistics.

WHY TIGTA DID THIS STUDY

The Tax Gap estimate is a widely used measure in tax policy and administration. Effective tax administration depends on comprehensive, reliable, accurate, and timely information to identify noncompliance and develop strategies to improve voluntary compliance. Increasing the Voluntary Compliance Rate is used by the IRS and the Department of the Treasury as the Agency Priority Goal. Policymakers are also considering tax reform. It is important that the Tax Gap estimate accurately reflects as many forms and areas of noncompliance as possible so that policymakers can accurately consider the impact on tax policy options.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Research, Analysis, and Statistics consider the following: (1) conduct a study to determine the feasibility of providing interim updates to the Tax Gap estimate; (2) ensure compliance with the applicable Office of Management and Budget standards; (3) issue a published report to explain the methods, assumptions, and premises used to develop the estimates; (4) develop the capability to estimate the Tax Gap for the informal economy; (5) perform a study to determine the feasibility of creating an estimate of the Tax Gap due to offshore tax evasion; (6) modify the estimation model for large corporations from using recommended tax from operational examinations to tax assessments from operational examinations; and (7) conduct a National Research Program review on small corporations.

In their response to the report, IRS officials agreed with all our recommendations.

Issued on August 21, 2013

THE INTERNAL REVENUE SERVICE NEEDS TO IMPROVE THE COMPREHENSIVENESS, ACCURACY, RELIABILITY, AND TIMELINESS OF THE TAX GAP ESTIMATE

IMPACT ON TAXPAYERS

The Tax Gap estimate is the difference between tax liability and the amount of tax paid voluntarily and on time in any given year. This estimate is a widely used measure in tax policy discussions, congressional hearings, IRS strategic planning, budgeting, and it also has other uses in the tax system. The overall objective of our evaluation was to provide information needed to assist in understanding how the Tax Gap estimate is used and derived and to determine whether additional information is needed. The Tax Gap estimate and its related component, the Voluntary Compliance Rate, are important to taxpayers because they are indicators of tax system fairness.

WHAT TIGTA FOUND

Several issues affect the comprehensiveness, accuracy, reliability, and the timeliness of the Tax Gap estimate. First, the Agency Priority Goal may require more frequent or interim updates to the estimate. The data also need to be verifiable and valid. Federal agencies are generally required to follow the Office of Management and Budget's (OMB) *Standards and Guidelines for Statistical Surveys*. However, the IRS develops the Tax Gap estimate in accordance with its own policies and procedures. These procedures do not adhere to several aspects of OMB Standards, including developing cost estimates, producing other estimates and projections, and conducting a formal peer review process.

Second, the individual Tax Gap estimate could be more comprehensive if it included estimates for the informal economy and offshore tax evasion. These areas present significant challenges to tax administration, and the absence of an estimate could hinder or delay possible solutions.

Third, there are two concerns about the accuracy and reliability of the Tax Year 2006 corporate underreporting Tax Gap estimate. First, the large corporate Tax Gap may be overstated due to using recommended tax from operational examinations rather than final assessments because large corporations often contest the initial determination. Second, the small corporate underreporting Tax Gap may suffer because operational results may be unrepresentative of the population and a significant portion of the population may exhibit the same characteristics as sole proprietorships.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treasury.gov/tigta/ireports/2013reports/2013ier008fr.pdf>