



## SHRINKING THE TAX GAP: BETTER IRS POLICING OF THE WEALTHY & CORPORATIONS WOULD ENSURE MORE OF WHAT'S OWED IS COLLECTED

### TOPLINES

- **Rich tax cheats evade about \$400 billion in taxes every year, stealing funding from vital public services like healthcare, education and infrastructure that benefit working families.** The wealthiest 1% are responsible for some 70% of the nation's estimated \$570 billion "tax gap"—the difference between taxes owed and taxes paid.
- **Our rigged tax system facilitates tax cheating by the wealthy.** While the income of working Americans is subject to employer withholding and verification, many forms of income the wealthy enjoy—such as from private businesses, rental property and stocks—are not subject to such scrutiny. More than half of all business income is misreported each year.
- **Republican weakening of the IRS has made tax evasion by the wealthy and corporations even easier.** Republicans have slashed the IRS's budget over the past decade, and the biggest cuts have been to enforcement. Audits of millionaires fell more than 80% over a recent nine-year span. All large corporations used to get audited every year, but in 2019 only about half were.
- **Unrigging our tax system and the broader economy requires giving the IRS the resources it needs to put an end to rampant tax evasion by the wealthy and corporations.** An initial step would be to restore the IRS budget to at least its 2010, inflation-adjusted amount—the funding level prior to Republican cuts. Beyond that, mandating minimum audit levels for the wealthy and corporations, plus more stringent reporting and third-party verification of wealthy taxpayers' income, would further limit cheating, raise needed revenues and restore faith in government.

### INTRODUCTION

In a bombshell report, the [New York Times](#) revealed that Donald Trump paid no federal income taxes in 11 out of 18 years, and just \$750 as President in 2017.<sup>1</sup> It is not clear whether Trump was guilty of aggressive tax dodging or had actually committed criminal tax evasion. Some items, like deducting \$70,000 worth of personal hair-care costs as a business expense and deducting a potentially [improper \\$700 million loss](#), point to evasion.<sup>2</sup>

Whether or not Trump is an example, tax evasion is rampant: the IRS estimates that in the most recent period studied the federal government each year failed to collect one in seven dollars owed. This annual ["tax gap" was pegged at \\$381 billion](#) in 2011-13 by the IRS.<sup>3</sup> It undoubtedly is much bigger today: [over \\$570 billion](#), by a former IRS Commissioner's estimate.<sup>4</sup> Economist Lawrence Summers (a former Treasury Secretary) and law professor Natasha Sarin expect the gap to grow to \$750 billion a year—a chasm of [\\$7.5 trillion over a decade](#).<sup>5</sup>

Experts estimate that roughly 70% of the tax gap can be blamed on tax deadbeats [among the nation's richest 1%](#).<sup>6</sup> Based on the estimated gap of \$570 billion, the wealthy and corporations are evading roughly \$400 billion a year in taxes. Rich tax cheats are bold because they know they are unlikely to get caught.

Republicans have repeatedly cut the IRS budget over the past decade, with some of the deepest reductions made to enforcement. The IRS has [lost about one-third of its enforcement staff between 2010-18](#).<sup>7</sup> With a smaller and less experienced staff the IRS shifted from tackling the potentially lucrative, complex tax scams of the wealthy and their army of lawyers to targeting low-income households whose alleged cheating is relatively minor but who lack the resources to reduce, delay and defeat enforcement actions.

If closed or at least substantially narrowed, the tax gap could better fund vital public services and restore faith in a system that lets too many rich Americans get away without paying their taxes.

## **DEFINING THE TAX GAP**

The [tax gap](#) is the difference between total taxes owed and taxes paid on time.<sup>8</sup> The great bulk of it comes from taxpayers hiding income and therefore minimizing their tax bill, but failure to pay the whole tax due and or even file a tax return at all contribute as well. By its very nature—an attempt to quantify cheating—the tax gap is an estimate.

In September 2019, the IRS published its most recent estimate, covering 2011 to 2013, which found the United States lost [an average of \\$381 billion in unpaid taxes annually](#) during this period.<sup>9</sup> (While these estimates theoretically include unreported income from assets hidden offshore, the audits used to make the estimates rarely catch such evasion and thus [understate some of the tax gap](#) attributable to cross-border activity.<sup>10</sup>)

The “gross” tax gap was \$441 billion before some tax evasion was caught by the IRS and punished—raising \$60 billion. The net amount of \$381 billion represented about one-seventh of the “true” total of taxes owed by individuals and businesses in each of those two years. So, for every \$7 in taxes owed, about \$1 in taxes went unpaid, even after enforcement.<sup>11</sup>

Those estimates attempt to capture the reality of almost a decade ago. Economic growth alone would likely have considerably widened the tax gap since then. Assuming cheating had not gotten worse, former IRS Commissioner Charles Rossotti estimates that the [2019 net tax gap was \\$574 billion](#).<sup>12</sup> However, there is good reason to believe tax evasion has gotten much worse since 2011 with the decline of effective enforcement (see below).

## **BIGGEST SOURCE OF THE TAX GAP: THE RICHEST ONE PERCENT**

The biggest tax cheats are rich. Summers and Sarin estimated that in 2019 [70% of the nation's tax evasion](#) was practiced by the wealthiest 1%.<sup>13</sup>

The wealthy can more easily cheat because a lot of their income is not subject to withholding by the IRS, as workers' wages are. Nor is much of their income independently reported to the IRS, like small investors' dividends and interest are. Many forms of income the wealthy enjoy—such as rent, capital gains, and business income—[are mostly or entirely self-reported](#).<sup>14</sup> Whereas the IRS estimates that just 1% of income subject to withholding and independent reporting is misreported by taxpayers each year, over half—55%—of business income is misreported.<sup>15</sup>

## REPUBLICAN WEAKENING OF THE IRS HAS MADE CHEATING EASIER

Over the past several decades, Congressional Republicans have intentionally weakened the IRS by [cutting its funding](#) (often as part of larger budget packages Democratic presidents were forced to sign).<sup>16</sup> Cuts made in the 1990s were restored in the early part of this century, but a second round of GOP reductions began in the century's second decade. Measured in constant 2018 dollars, IRS funding peaked in 2010 at \$14.2 billion and by 2018 [was down by 17%](#) even as the IRS was loaded up with greater responsibilities—implementation of tax provisions in the Affordable Care Act of 2010 and the Tax Cuts and Jobs Act of 2017.<sup>17</sup>

House Democrats have started an effort to claw back some of these latest cuts; the House-passed 2021 budget [increased the agency's funding by \\$606 million](#) over 2020 levels.<sup>18</sup> As of November 2020, the Senate version of the legislation omitted this increase.

- **The harshest cuts were made to enforcement.** Between 2010-18, [funding for examinations and collections was cut](#) by 33% and for investigations by 28%.<sup>19</sup> As a result, the agency lost almost a third of its enforcement personnel, the staff shrinking from 45,000 to 31,000. That big decline involved the IRS losing over a third (35%) of its revenue agents, 41% of its tax technicians, and nearly half (48%) of its revenue officers.
- **Enforcement fell with funding and staff.** According to the latest IRS enforcement statistics, the [number of audits fell by more than half](#) between 2010-19, from over 1.7 million in 2010 to less than 800,000 in 2019.<sup>20</sup> The audit *rate*—how many audits per 100 returns—also fell by half, from 1% to 0.5%. An independent search by ProPublica determined this was the [lowest audit rate in over 60 years](#) at least.<sup>21</sup>
- **Less enforcement means less revenue collected.** In 2010, the IRS collected around \$28 billion (adjusting for inflation) from the examination and appeal process. In 2019, such audit collections had [declined 61%](#), to just \$11 billion.<sup>22</sup>
- **The steepest declines were in the audits of the richest taxpayers.** For those at the top, all this politically motivated budget cutting paid off: the audit rate for taxpayers with income over \$1 million was [down 81% in 2019](#) compared with 2011.<sup>23</sup> Meanwhile, the audit rate for taxpayers reporting between \$25,000 to \$200,000 held roughly steady between 2010-16

(2016 is the most recent year with final figures; later-year figures may increase as new cases are opened).<sup>24</sup>

- Millionaires now get audited at close to the same level as workers with less than \$20,000 of annual income. While 12.5% of millionaires were audited in 2011, only 2.4% were in 2019. That is [close to the 1.1% level](#) at which the IRS audits recipients of the Earned Income Tax Credit (EITC), who average \$20,000 in annual income.<sup>25</sup> Instead of Manhattan or Beverly Hills, the community with the [highest audit rate in the nation](#) is a rural, majority-Black county in Mississippi with a median household income of just \$26,000.<sup>26</sup>
- **The IRS is failing to pursue high income individuals who do not even bother to file a return.** According to a Treasury Inspector General for Tax Administration (TIGTA) report, the [IRS failed to pursue 879,415 high-income non-filers](#) in tax years 2014-2016.<sup>27</sup> This group had nearly \$46 billion in taxes due over this time period. Also noteworthy, the IRS [never opened investigations](#) into more than 300,000 of the non-filers, shelved about 37,000 cases, and did not prioritize auditing non-filers who did not file tax returns in multiple years.<sup>28</sup>
- **Corporate audits also took a big hit.** The largest corporations, those with assets over \$20 billion, used to be audited every year. In 2019, [only about half were audited](#).<sup>29</sup> IRS resources are stretched so thin that corporations often keep questionable tax savings because the statute of limitations runs out before tax enforcement officers resolve the case. A new analysis of financial reports for 2019 shows that five companies—Chevron, Dell, Eli Lilly, ExxonMobil and General Electric—[kept \\$1 billion in tax breaks](#) they admitted were probably illegal because tax authorities failed to come to a final determination before the statute of limitations ran out.<sup>30</sup>

## PROPOSALS FOR CLOSING THE TAX GAP

Many experts in and out of government have issued proposals for closing the tax gap.

- **Congressional Budget Office (CBO):** CBO has determined that modest increases to the IRS's enforcement budget [would pay for themselves several times over](#) by reducing the tax gap.<sup>31</sup> CBO found that over a 10-year period an extra \$20 billion in enforcement funding would yield \$61 billion in revenue and an extra \$40 billion would generate \$103 billion, for net revenue increases of \$41 billion and \$63 billion, respectively.
- **Sarin & Summers:** Law professor Natasha Sarin and former Treasury Secretary Larry Summers anticipate much higher returns from IRS reforms: [some \\$1.15 trillion](#) over 10 years.<sup>32</sup> They estimate returning audit rates to the higher 2011 levels would bring in roughly \$715 billion, including \$535 billion from individuals and \$143 billion from corporations. Improved third-party income reporting would bring in approximately \$346 billion, while updating antiquated IRS technology would reap around \$100 billion.

They also propose assessing the role of the tax code in racial inequities and the racial wealth gap. They would require the Statistics of Income Division of the IRS and the Office of Tax Analysis at Treasury to include race and ethnicity in their tax data analysis, and the IRS Commissioner to document, in consultation with the Office of the Taxpayer Advocate and the Department of Justice (DOJ) Office of Civil Rights, that tax enforcement actions do not vary by race or ethnicity.

- **Former IRS Commissioner Charles Rossotti:** In combination with a substantial funding increase for IRS enforcement, Rossotti believes a revamped income-reporting system could [close the tax gap by \\$1.6 trillion](#) over 10 years.<sup>33</sup> His plan would require business owners with over \$25,000 of business income to list the account numbers of all their bank accounts on their returns. Banks, for their part, would be required to file a W-2 style form with a summary of deposits and disbursements. The taxpayer would fill out a schedule reconciling these amounts.
- **Rep. Peter DeFazio (D-OR), Chairman of the House Transportation and Infrastructure Committee:** He has introduced the IRS Enhancement and Tax Gap Reduction Act of 2020 ([H.R. 6076](#)), which restores the IRS’s funding and capacity. The bill mandates minimum audit levels for large corporations and the rich, appropriating over \$10 billion in additional funding per year over a 10-year period to help the IRS meet its targeted goals. While [some observers are skeptical](#) the agency could absorb so much additional funding that quickly,<sup>34</sup> it is clear a long-term commitment to increasing IRS resources will be necessary to reverse past losses and make sure the IRS can develop [trained staff in sufficient numbers](#) to ensure the rich pay what they owe.<sup>35</sup>

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<sup>1</sup> *New York Times* (NYT), “18 Revelations from a Trove of Trump Tax Records” (Sept. 27, 2020).

<https://www.nytimes.com/2020/09/27/us/trump-taxes-takeaways.html>

<sup>2</sup> NYT, “Long-Concealed Records Show Trump’s Chronic Losses and Years of Tax Avoidance” (Sept. 27, 2020).

<https://www.nytimes.com/interactive/2020/09/27/us/donald-trump-taxes.html>

<sup>3</sup> Internal Revenue Service (IRS), “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013” (Sept. 2019), p. 1. <https://www.irs.gov/pub/irs-pdf/p1415.pdf>

<sup>4</sup> Tax Notes, “Recover \$1.6 Trillion, Modernize Tax Compliance and Assistance: The How-To” (Sept. 14, 2020), p. 1962. <https://shrinkthetaxgap.com/reform-proposal-2/>

<sup>5</sup> NYT, “The I.R.S. Is Outgunned” (Oct. 2, 2020). <https://www.nytimes.com/2020/10/02/opinion/sunday/irs-tax-income-inequality.html>

<sup>6</sup> *Washington Post* (WP), “Yes, Our Tax System Needs Reform. Let’s Start with This First Step” (Nov. 17, 2019). [https://www.washingtonpost.com/opinions/yes-our-tax-system-needs-reform-lets-start-with-this-first-step/2019/11/17/4d23f8d4-07dd-11ea-924a-28d87132c7ec\\_story.html](https://www.washingtonpost.com/opinions/yes-our-tax-system-needs-reform-lets-start-with-this-first-step/2019/11/17/4d23f8d4-07dd-11ea-924a-28d87132c7ec_story.html)

<sup>7</sup> Center for American Progress (CAP), “Unrigging the Economy Will Require Enforcing the Tax Laws” (Mar. 12, 2020), paragraph 27. <https://www.americanprogress.org/issues/economy/reports/2020/03/12/481539/unrigging-economy-will-require-enforcing-tax-laws/>

<sup>8</sup> Tax Policy Center (TPC), “Briefing Book: What is the Tax Gap?” (May 2020).

<https://www.taxpolicycenter.org/briefing-book/what-tax-gap>

<sup>9</sup> Internal Revenue Service (IRS), “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013” (Sept. 2019), p. 1. <https://www.irs.gov/pub/irs-pdf/p1415.pdf>

<sup>10</sup> CAP, “Unrigging the Economy,” paragraph 24.

<sup>11</sup> *Ibid.*, paragraph 12.

<sup>12</sup> Tax Notes, “Recover \$1.6 Trillion,” p. 1962.

<sup>13</sup> WP, “Yes, Our Tax System Needs Reform.”

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- <sup>14</sup> NYT, “The I.R.S. Is Outgunned” (Oct. 2, 2020). <https://www.nytimes.com/2020/10/02/opinion/sunday/irs-tax-income-inequality.html>
- <sup>15</sup> IRS, “Federal Tax Compliance Research,” p. 3.
- <sup>16</sup> ProPublica, “How the IRS Was Gutted” (Dec. 11, 2018). <https://www.propublica.org/article/how-the-irs-was-gutted>
- <sup>17</sup> CAP, “Unrigging the Economy,” paragraph 26.
- <sup>18</sup> Congressional Research Service (CRS), “IRS Appropriations, FY2021” (Aug. 26, 2020). <https://crsreports.congress.gov/product/pdf/IF/IF11607#:~:text=The%20Trump%20Administration%20has%20requested,the%20enacted%20amount%20for%20FY2020.>
- <sup>19</sup> CAP, “Unrigging the Economy,” paragraph 27.
- <sup>20</sup> IRS, “Internal Revenue Service Data Book: October 1, 2018 to September 30, 2019” (June 2020), p. 33. <https://www.irs.gov/pub/irs-pdf/p55b.pdf>
- <sup>21</sup> ProPublica, “Has the IRS Hit Bottom?” (June 30, 2020) <https://www.propublica.org/article/has-the-irs-hit-bottom>
- <sup>22</sup> *Ibid.*
- <sup>23</sup> CAP, “IRS Budget Cuts Let Wealthy Tax Cheats Get Away with It” (Aug. 6, 2020). <https://www.americanprogress.org/issues/economy/news/2020/08/06/488840/irs-budget-cuts-let-wealthy-tax-cheats-get-away/>
- <sup>24</sup> IRS, “Data Book,” p. 34.
- <sup>25</sup> ProPublica, “Has the IRS Hit Bottom?”
- <sup>26</sup> ProPublica, “Where in The U.S. Are You Most Likely to Be Audited by the IRS?” (Apr. 1, 2019). <https://projects.propublica.org/graphics/eitc-audit>
- <sup>27</sup> Treasury Inspector General for Tax Administration (TIGTA), “High-Income Nonfilers Owing Billions of Dollars Are Not Being Worked by The Internal Revenue Service” (May 29, 2020). [https://www.treasury.gov/tigta/auditreports/2020reports/202030015\\_oa\\_highlights.html](https://www.treasury.gov/tigta/auditreports/2020reports/202030015_oa_highlights.html)
- <sup>28</sup> The Hill, “Democrats Press IRS Over Report That It Failed to Audit High-Income Non-Filers” (June 17, 2020). <https://thehill.com/policy/finance/503133-senate-democrats-press-irs-over-report-that-it-failed-to-audit-high-income-non>
- <sup>29</sup> ProPublica, “Has the IRS Hit Bottom?”
- <sup>30</sup> Institute of Tax and Economic Policy (ITEP), “An Underfunded IRS Allows Corporations to Get Away with Probably Illegal Tax Dodges” (Oct. 28, 2020). <https://itep.org/an-underfunded-irs-allows-corporations-to-get-away-with-probably-illegal-tax-dodges/>
- <sup>31</sup> Congressional Budget Office (CBO), “Trends in the Internal Revenue Service’s Funding and Enforcement” (July 2020). <https://www.cbo.gov/system/files/2020-07/56422-CBO-IRS-enforcement.pdf>
- <sup>32</sup> Tax Notes, “Shrinking the Tax Gap: Approaches and Revenue Potential” (Nov. 18, 2019). <https://www.taxnotes.com/special-reports/compliance/shrinking-tax-gap-approaches-and-revenue-potential/2019/11/15/2b47g>
- <sup>33</sup> Tax Notes, “Recover \$1.6 Trillion,” p. 1964.
- <sup>34</sup> TPC, “How Much More Money Could the IRS Collect If Congress Gave Them More Money?” (Sept. 28, 2020). <https://www.taxpolicycenter.org/taxvox/how-much-more-money-could-irs-collect-if-congress-gave-them-more-money>
- <sup>35</sup> ProPublica, “The IRS Tried to Take on the Ultrawealthy. It Didn’t Go Well” (April 5, 2019). <https://www.propublica.org/article/ultrawealthy-taxes-irs-internal-revenue-service-global-high-wealth-audits>