INTERNAL REVENUE SERVICE

IRS Fact Sheet

Media Relations Office | Washington, D.C. | Media Contact: 202.622.4000

www.IRS.gov/newsroom | Public Contact: 800.829.1040

IRS Releases 2006 Tax Gap Estimates

FS-2012-6, January 2012

The tax gap is defined as the amount of tax liability faced by taxpayers that is not paid on time. The Internal Revenue Service collects more than $2 trillion annually in taxes so producing an estimate of the tax gap is a major statistical effort that it undertakes every few years.

This month, the IRS released a new set of tax gap estimates for tax year 2006. The new tax gap estimate represents the first full update of the report in five years, and it shows the nation's compliance rate is essentially unchanged at about 83 percent from the last review covering tax year 2001.

The net tax gap for 2006 is estimated to be $385 billion. The net tax gap takes into account receipts from enforcement activities and late payments.

Since IRS Commissioner Doug Shulman began his five-year term in March 2008, virtually all major initiatives launched by the IRS since 2008 have been designed to focus on the tax gap through more effective enforcement or improved service to taxpayers.

The tax gap statistic is a helpful guide to the scale of tax compliance and to the persisting sources of low compliance, but it is not an adequate guide to year-to-year changes in IRS programs or to year-to-year returns on IRS service and enforcement initiatives.

Tax gap estimates take years to produce. For example, taxpayers have until late 2007 to file 2006 tax returns, and it takes several years to measure IRS enforcement of those liabilities from 2006. Furthermore, statistically valid estimates require resource-intensive, time-consuming research gathered from a wide range of sources, including statistically selected audits of taxpayers. Other information, such as income and expenditure information from other sources, additional financial information, and information about best practices in tax return examination, supplement the audit findings.

Here are some of the most important initiatives that the IRS has recently put in place to address the tax gap:

Tax Return Preparers

The IRS initiated a comprehensive review of the tax return preparation industry in 2009. A multi-faceted return preparer strategy was launched in 2010 to ensure top-notch professional and ethical service to taxpayers. Prior to this initiative, only CPAs, attorneys and Enrolled Agents were subject to professional credentialing. All other paid return preparers were not subject to any mandatory training or testing.

- The compliance strategy is being phased in over several years. The end result will be: all paid return preparers will be registered with the IRS, identified on the returns they prepare, pass a competency exam, and complete annual continuing education of tax law and professional conduct.
- This compliance strategy will cut down on inaccurate and fraudulent returns. It also makes it easier for the IRS to catch unscrupulous return preparers. In addition, these efforts will help improve service to taxpayers and assist with voluntary compliance.

Basis Reporting

Third-party reporting and transparency is also crucial to high compliance among individual taxpayers. Basis reporting associated with the buying and selling of securities was an area that was in need of third-party reporting based on previous studies that showed low levels of compliance.

The IRS issued proposed regulations in 2009 and final regulations in 2010 under a new law that will require reporting of basis and other information by stock brokers and mutual fund companies for most stock purchased in 2011 and all stock purchased in 2012 and later years. The reporting will be made to investors and the IRS.

Business Taxes

Third-party reporting and transparency are hallmarks of high levels of tax compliance. The IRS undertook several initiatives in recent years to improve those aspects in the world of business taxes, where the efficient allocation of limited resources is particularly important to sound tax administration.

- New merchant card reporting requirements were established for the 2011 tax year. They provide third-party reporting data on business receipts for the first time, making it easier for the IRS to identify businesses that are either under-reporting receipts or not reporting at all. The IRS issued final regulations in 2010 and the new reporting requirements took effect on Jan. 1, 2011. In general, these requirements apply to government entities and private businesses, as well as most types of payment cards, such as credit and debit cards.
- In recent years, the IRS has focused its business audits more toward issues with the highest compliance risks. Risk-based audit selection leads to a more-efficient use of limited resources and a higher return on investment. The IRS continues to improve its exam selections to focus on the most-pressing issues.

Offshore Tax Avoidance

Stopping offshore tax cheating and getting these people, especially high net-worth individuals, back into the tax system has been a top priority of the IRS.

- An offshore voluntary disclosure program was made available in 2009 and again in 2011. So far the two voluntary disclosure programs have encouraged over 30,000 taxpayers to come forward and get right with the U.S. tax system, and billions of dollars in back taxes, interest and penalties have been collected to date.
- Offshore tax avoidance is also being addressed through actions against foreign banks that have helped U.S. taxpayers hide their assets. A landmark enforcement victory against a Swiss bank in 2009 has led to the erosion of Swiss bank secrecy, and work by the IRS and Justice Department continues in this area.
- The Foreign Account Tax Compliance Act (FATCA), which was enacted in 2010 and requires foreign financial institutions to report to the IRS information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. FATCA will be phased in by the IRS in the next several years.

Other International Efforts

Globalization of the U.S. economy has been a major trend for many years. In response, the IRS realigned its relevant business divisions and personnel to address the changing landscape for both big companies and high-net-worth individuals who use ever-more sophisticated investment strategies.

- In August 2010, the IRS announced the realignment of the Large and Mid-Size Business (LMSB) division to create a more centralized organization dedicated to improving international tax compliance, known as the Large Business and International division (LB&I).
- This move strengthened international tax enforcement in several ways, including identifying emerging international compliance issues more quickly and ensuring the right compliance resources are allocated to the right cases. More IRS staff is focusing on and specializing around international issues.
- In November 2009, the IRS's Global High Wealth unit began operation. It was formed to better cope with the growing complexity of income and assets of the high-income, high-wealth population.

Uncertain Tax Positions

In 2011, certain large corporations were required to start making "uncertain tax position" (UTP) disclosures on their 2010 tax returns. The IRS issued the final UTP Schedule and instructions in September 2010. UTP reporting fosters certainty for taxpayers by speeding up the time it takes to find issues and complete exams. It also helps the IRS work through corporate returns more efficiently and see where further guidance is needed to reduce uncertainty. A UTP is generally defined as a stance on a tax return where the corporation sets aside a reserve to either pay the higher amount of tax later or litigate the matter in the future.

Real-Time Tax System

The IRS has started work exploring how to implement a series of long-term changes to the tax system which will result in higher compliance. Commissioner Shulman has described a vision where the IRS would move away from the traditional "look back" model of compliance, and instead perform substantially more “real time,” or upfront information return matching with tax returns when they are first filed with the IRS. The goal of this initiative is to improve the tax filing process by reducing burden for taxpayers and improving overall compliance upfront.

In general, the IRS is one of the world's most efficient tax administrators. In fiscal year 2010, the IRS collected more than $2.3 trillion in revenue and processed more than 230 million tax returns, while spending just 53 cents for each $100 collected. The IRS takes a balanced approach to tax administration.

—30—