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# The Underpayment Tax Gap for Tax Years 2014-2016

## Executive Summary

Taxpayers are required by the Internal Revenue Code to file income tax returns with the IRS by the established due date, on which they are to report all of their tax liability; it also requires them to pay that tax liability on time. However, not all taxpayers pay on time the tax that they report on their returns. The gross underpayment tax gap<sup>1</sup> for a given tax year (or range of tax years) is the amount of tax that is reported on timely filed returns but is not paid on time. For Tax Years 2011 to 2013, the average gross underpayment gap was \$50 billion, accounting for around 11 percent of the gross tax gap but was only 1.91 percent as large as total IRS collections for the corresponding fiscal year.<sup>2</sup> For the Tax Year 2014 to 2016 period, the average annual underpayment gap was \$56 billion, and was 1.73 percent as large as total IRS collections. As one might expect, when taxpayers voluntarily report a certain amount of tax as due, they tend to pay it on time or soon after it is due. In fact, the underpayment gap consistently represents less than 2 percent of the tax that is reported on timely filed returns, and around two-thirds of that is consistently paid within three years.

Since the amounts reported on timely returns and the amounts paid are observed, we are generally able to tabulate payment compliance measures from IRS systems for each tax year and each type of tax without estimation.<sup>3</sup> This report documents various measures related to the underpayment gap for Tax Years 2014 through 2016. The basic estimates are provided in Section 1. Section 2 explains the unique role of employer underdeposits of withheld income tax, and Section 3 provides underpayment gap estimates by type of tax.

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<sup>1</sup> Hereinafter referred to simply as the underpayment gap.

<sup>2</sup> Gross collections from the *IRS Data Book*, Table 1. [SOI Tax Stats - IRS Data Book](#)

<sup>3</sup> There is one small exception to this rule (employer underdeposit of withheld income tax), which is explained in Section 2.

## Introduction

The gross underpayment gap for a given tax year is the amount of tax that is reported on timely filed returns for that tax year but is not paid on time. The corresponding Voluntary Payment Compliance Rate (VPCR) is the percentage of tax that is reported on timely filed returns and is paid timely, while the Payment Noncompliance Rate is 100% minus the VPCR. The Cumulative Payment Compliance Rate (CPCR) is the percentage of tax that is reported on timely filed returns and is paid within a specified amount of time after the close of the tax year. Finally, the net underpayment gap for a given tax year is the amount of the gross underpayment gap that is still not paid after a specified amount of time.<sup>4</sup>

### 1. Estimates

Since the amounts reported on timely returns and the amounts paid are generally observed, we are able to tabulate these payment compliance measures from IRS systems for each tax year without estimation. However, we need to modify these tabulations for individual income tax and employment tax to account for employer underdeposits of withheld income tax, as described in Section 2. Table 1 shows the final measures for Tax Years 2003-2016 for all types of tax combined.

**Table 2. Underpayment Gap Measures,  
Tax Years 2003-2016**

Tax Year	Gross Underpayment Gap (\$ B)	Voluntary Payment Compliance Rate
2003	29.3	98.6%
2004	33.1	98.6%
2005	39.7	98.5%
2006	40.4	98.6%
2007	41.1	98.7%
2008	41.0	98.6%
2009	36.5	98.6%
2010	39.1	98.6%
2011	46.2	98.0%
2012	50.8	97.8%
2013	56.9	97.7%
2014	58.7	98.0%
2015	57.7	98.1%
2016	54.4	98.2%

<sup>4</sup> We do not project future payments of the underpayment gap separately from the other components of the tax gap for a given tax year.



## 2. Employer Underdeposit of Withheld Income Tax

Basic tabulations of the underpayment gap from the IRS Master File treat withheld income tax as an employment tax since it is actually paid (deposited) by employers on behalf of their employees. However, the ultimate tax liability that these payments are intended to satisfy is the income tax liability of the individual employees. So, we must adjust those basic tabulations in two ways.

1. Transfer amounts from employment tax to individual income tax: If an employer reports on time the amount that he had withheld from employees, but he didn't deposit it on time, that amount would be characterized in the basic tabulations as part of the employment tax underpayment gap; we need to characterize it instead as part of the individual income tax underpayment gap. We are now able to tabulate withheld income tax separately from employment taxes on the various employment tax forms (Forms 941, 943, 944, 945, and 1042), so this is straightforward.
2. Add in amounts not reported on time by the employer: If an employer withholds income tax from his employees but *doesn't report it on time* (or pay it on time), that amount will not be included in the basic tabulations since they are based solely on timely filed returns. The reason why these amounts should be included in the underpayment gap is that they are ultimately payments of individual income tax, and we assume that the individual employee reported the tax liability (and withholding) on time, even though the employer didn't pay it on time on his behalf.

We identify these amounts associated with late or missing employment tax returns using separate tabulations. However, the amounts tabulated are just what was unpaid *as of the date of the tabulation*. Since the amount associated with late returns filed after the tabulations is likely to be quite small, these special tabulations presumably capture almost all the amount that could eventually be observed in tax records. However, an unknown amount is presumably withheld from employees and never paid to the government by their employers; we do not estimate this amount, even though it is by definition part of the individual income tax underpayment gap.

## 3. Separating Self-Employment Tax

Self-employment tax is reported by individuals on their Form 1040. Because this is a type of employment tax, we need to move this portion of the underpayment gap from the individual income tax underpayment gap to the employment tax underpayment gap. The basic tabulation from IRS systems doesn't distinguish between the two, so we tabulate the total underpayment gap associated with Form 1040, then allocate that gap between individual income tax and employment tax proportional to their reported tax liabilities.

#### 4. Underpayment Tax Gap Measures by Type of Tax

The underpayment gap amounts are tabulated from IRS Master File data by type of tax from the relevant tax forms, as listed in Table 2.

**Table 3. Tax Forms Included in Each Type of Tax**

Type of Tax	Tax Form	Subject / Title
Individual income tax	1040	Individual Income Tax
Corporation income tax	1120	Corporation Income Tax
Employment tax	940	Annual Unemployment Tax
	941	Employer Quarterly Tax
	943	Employer Annual Tax (Agricultural)
	944	Employer Annual Federal Tax
	945	Annual Return of Withheld Income Tax
	1042	U.S. Source Income of Foreign Persons
	CT1	Railroad Retirement and Unemployment
Excise taxes	11C	Tax Return for Registry - Wagering
	2290	Heavy Highway Vehicle Use Tax
	720	Quarterly Excise Tax
	730	Monthly Tax Return for Wagers
Other	1041	Fiduciary Income Tax
	4720	Excise Taxes on Charities
	5330	Excise Taxes Related to Employee Benefit Plans
	706-GS(D)	Generation-Skipping Transfer Tax for Distributions
	706-GS(T)	Generation-Skipping Transfer Tax for Termination
	709	Gift Tax
	8288A	Dispositions by Foreign Persons - U.S. Property
	8752	Payment or Refund under Section 7519
	8804	Foreign Partnership Withholding Tax
	990PF	Return of Private Foundation
990T	Exempt Organization Business Tax	

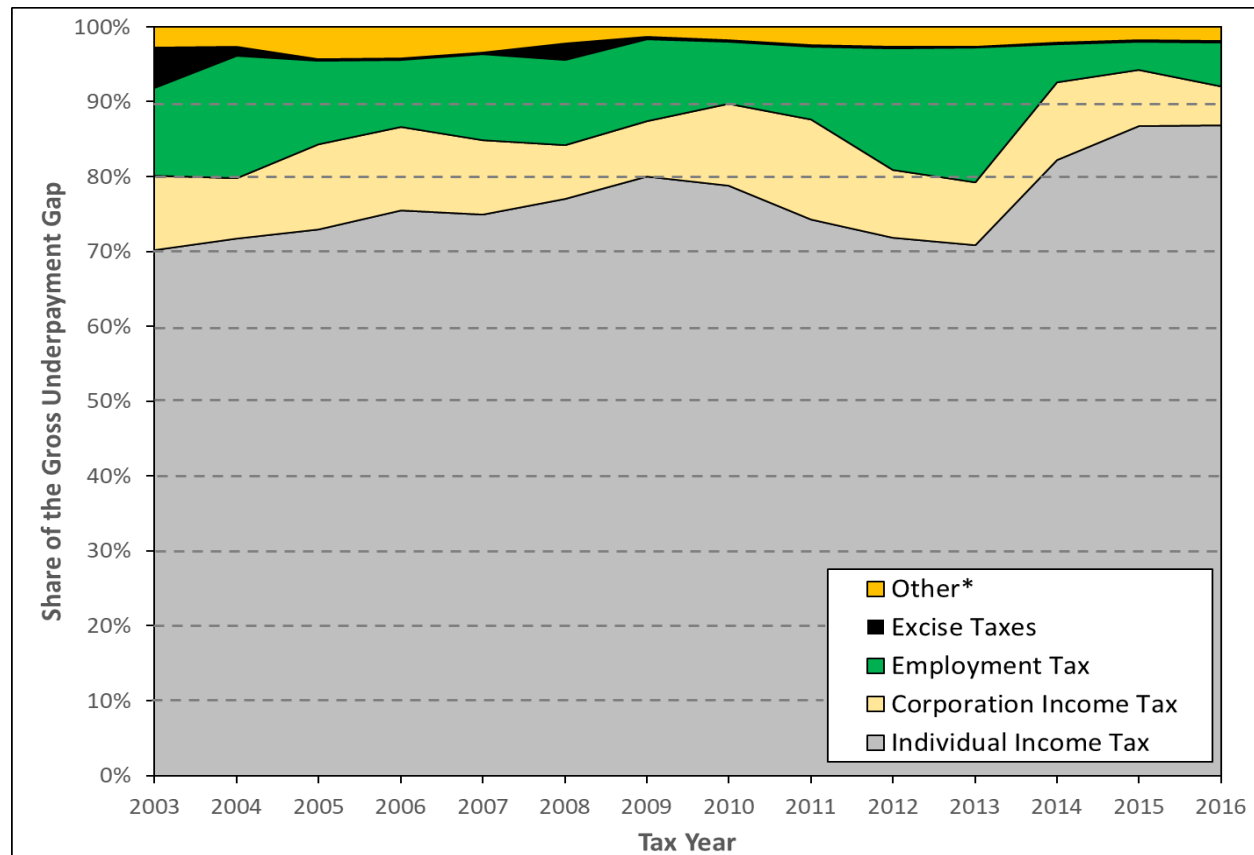
Having made the adjustments for employer underdeposit of withheld income tax and self-employment tax, the underpayment gap is tabulated by type of tax and by tax year in Table 3 and illustrated in Figure 1. The corresponding payment noncompliance rates are provided in Table 4. These reveal that growth in the overall underpayment gap has been driven by individual income tax, partly because the individual income tax payment noncompliance rate has been increasing somewhat (Table 4). That may be caused in part by the growing share of sole proprietors during this period and the fact that it is often much harder for sole proprietors to make timely tax payments throughout the year than is the case for employees, who have taxes withheld from their paychecks.

**Table 3. Gross Underpayment Tax Gap by Type of Tax, Tax Years 2003-2016 (\$ B)**

Tax Year	Individual Income Tax	Corporation Income Tax	Employment Tax	Excise Taxes	Other*	Total
2003	20.5	2.9	3.4	1.6	0.8	29.3
2004	23.8	2.7	5.4	0.4	0.9	33.1
2005	28.9	4.5	4.4	0.1	1.7	39.7
2006	30.5	4.5	3.6	0.1	1.7	40.4
2007	30.8	4.1	4.7	0.1	1.4	41.1
2008	31.6	2.9	4.7	0.9	0.9	41.0
2009	29.2	2.7	4.0	0.1	0.5	36.5
2010	30.8	4.3	3.2	0.1	0.7	39.1
2011	33.1	6.0	4.3	0.1	1.1	46.2
2012	37.9	4.8	8.6	0.1	1.4	50.8
2013	43.2	5.1	11.0	0.1	1.6	56.9
2014	46.6	5.9	2.9	0.1	1.2	58.7
2015	48.2	4.2	2.1	0.1	1.0	57.7
2016	45.6	2.7	3.1	0.1	1.0	54.4
2014-16 Average	46.8	4.3	2.7	0.1	1.1	56.9

\* Mostly estate & gift taxes

**Figure 1. Shares of the Gross Underpayment Tax Gap by Type of Tax, Tax Years 2003-2016**



\* Mostly estate & gift taxes

**Table 4. Payment Noncompliance Rate by Type of Tax, Tax Years 2003-2016**

Tax Year	Individual Income Tax	Corporation Income Tax	Employment Tax	Excise Taxes	Other*	Total
2003	2.7%	1.9%	0.5%	3.2%	7.7%	1.4%
2004	2.9%	1.4%	0.6%	0.8%	5.9%	1.4%
2005	3.1%	1.7%	0.5%	0.2%	8.8%	1.5%
2006	3.0%	1.4%	0.4%	0.2%	6.9%	1.4%
2007	2.8%	1.3%	0.4%	0.1%	4.8%	1.3%
2008	3.1%	1.2%	0.4%	2.0%	4.7%	1.4%
2009	3.4%	1.4%	0.4%	0.2%	3.4%	1.4%
2010	3.3%	2.0%	0.4%	0.2%	3.5%	1.4%
2011	3.0%	2.6%	0.5%	0.1%	5.4%	2.0%
2012	3.1%	1.8%	1.0%	0.3%	4.5%	2.2%
2013	3.4%	1.7%	1.1%	0.2%	5.3%	2.3%
2014	3.3%	1.8%	0.3%	0.2%	4.3%	2.0%
2015	3.2%	1.4%	0.2%	0.2%	3.7%	1.9%
2016	3.0%	1.0%	0.3%	0.2%	4.0%	1.8%
2014-16 Average	3.2%	1.4%	0.3%	0.2%	4.0%	1.9%

\* Mostly estate & gift taxes