Some Background

What is the tax gap?

Q. What is the tax gap?

A. The gross tax gap is the difference between total taxes owed and taxes paid voluntarily and on time.

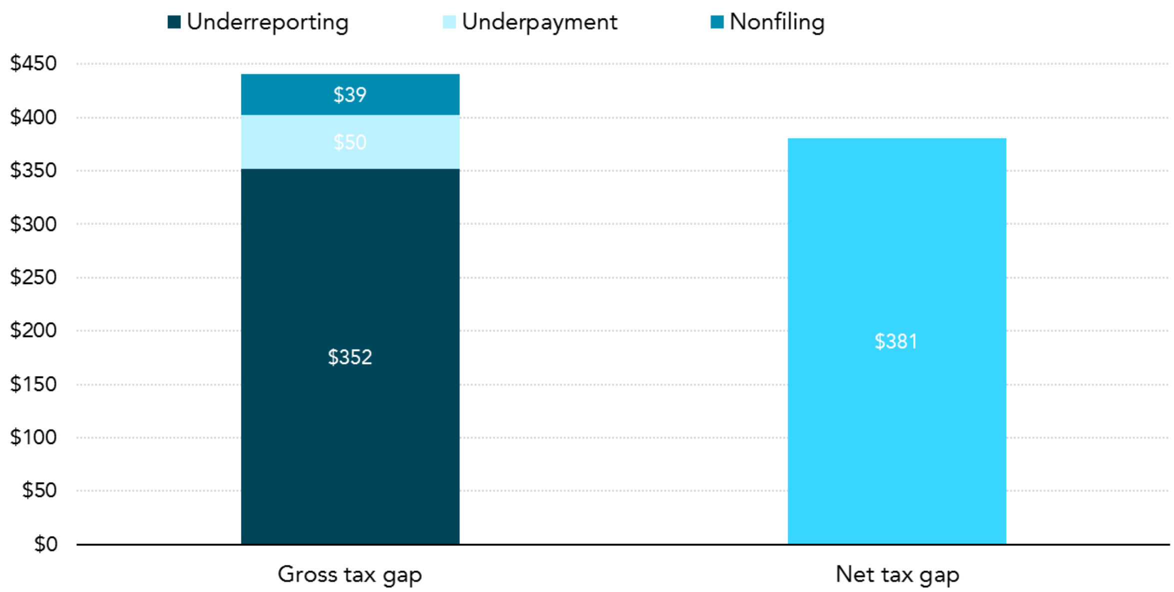
The Internal Revenue Service (IRS) estimates that over the past 30 years, the tax gap has fluctuated in a narrow range—15 to 18 percent of total tax liability. Some view the tax gap as a possible major revenue source that could be used to close the federal budget deficit without raising taxes. In practice, though, the potential revenue gains from proposals to improve enforcement are quite limited.

The most recent IRS tax gap report was released in 2019 and covered tax years 2011–13 (IRS Research, 2019). For those years, the IRS reported an average annual gross tax gap of $441 billion (slightly over 16 percent of total tax liability). Of this, the IRS eventually recovered $60 billion through voluntary late payments and enforcement activities. That left average annual net tax gap of about $381 billion (or about 14 percent of total tax liability).

FIGURE 1

Components of the Tax Gap

Billions of dollars, tax years 2011 to 2013



Source: Internal Revenue Service. "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013," publication 1415 (rev. September 2019).
Notes: Estimates are annual averages for the tax years 2011 to 2013 timeframe.

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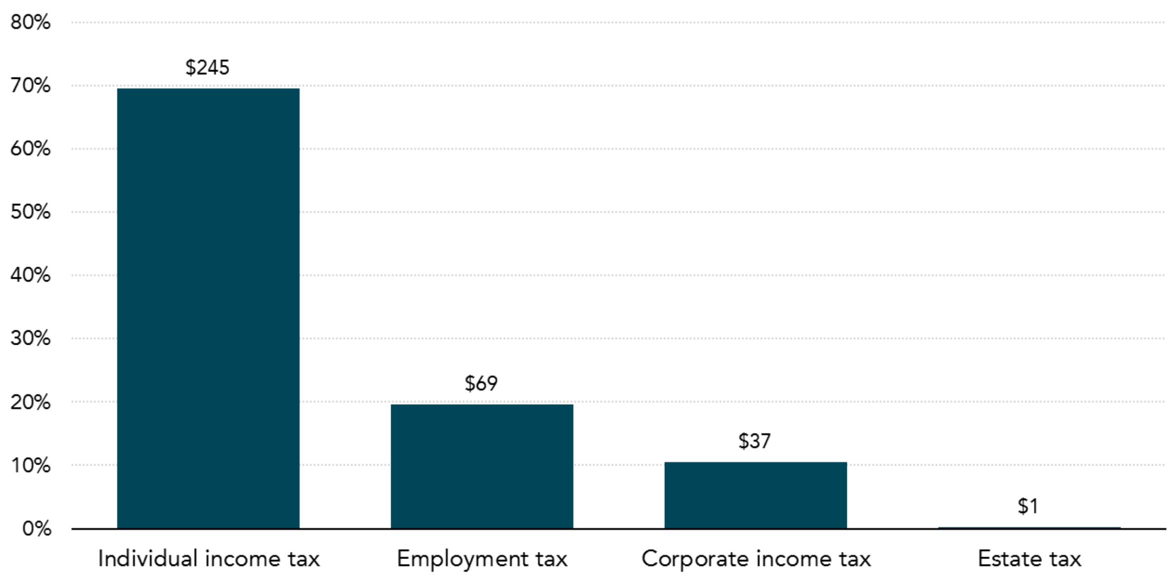
Failure to file a tax return (nonfiling) and underpayment of reported taxes account for 20 percent of the gross tax gap (figure 1). Underreporting on timely filed tax returns makes up the bulk of it: $352 billion, or 80 percent of the gross tax gap.

Underreporting on individual income tax returns alone (including self-employment tax) was $245 billion (figure 2), about 70 percent of the underreporting tax gap in 2011–13. Almost 45 percent of the underreported individual income tax is owed on business income, which the IRS has no easy way to verify independently. About 11 percent of the underreporting gap is attributable to corporate income tax, and only 0.3 percent to the estate tax.

FIGURE 2

Components of the $352 Billion Underreporting Gross Tax Gap

Share of total and billions of dollars, tax years 2011 to 2013



Source: Internal Revenue Service. "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013," publication 1415 (rev. September 2019).
Notes: Estimates are annual averages for the tax years 2011 to 2013 timeframe.

Individual taxpayers fail to report about 55 percent of income from sources for which there is no information reporting, such as sole proprietorships. In contrast, only 5 percent of income from easily verified sources—interest, dividends, and pensions—goes unreported. When income is subject to both information returns and tax withholding, as with wages, only about 1 percent goes unreported.

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Data Sources

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Further Reading

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