



Highlights of GAO-05-878, a report to House Majority Leader Thomas DeLay, and the Honorable John Linder, House of Representatives

# TAX POLICY

## Summary of Estimates of the Costs of the Federal Tax System

### Why GAO Did This Study

In 2005, Americans will pay about \$2.1 trillion in combined federal taxes, including income, payroll, and excise taxes, or about 16.8 percent of Gross Domestic Product (GDP). However, the amount of taxes paid does not reflect the total cost to taxpayers of the federal tax system. In addition to taxes paid, taxpayers also bear compliance costs and efficiency costs. Understanding the magnitude of these additional costs is important because every dollar spent on compliance and lost due to inefficiency represents a dollar that society could have spent for other purposes.

In response to a congressional request for information on the magnitude of the compliance and efficiency costs of the current federal tax system, this study describes the nature of these costs, presents the difficulties associated with estimating them, and summarizes existing estimates of their magnitude. GAO did not make independent estimates of compliance or efficiency costs nor did we replicate any of the studies.

GAO is not making any recommendations in this report.

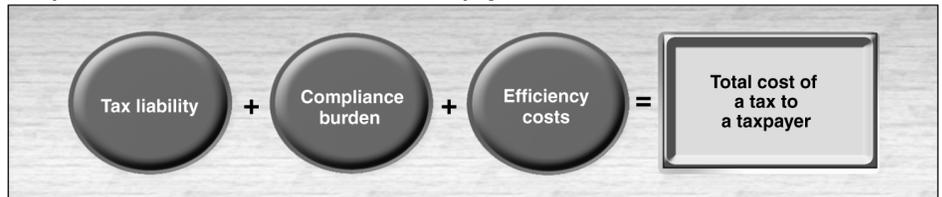
### What GAO Found

Complying with the federal tax system costs taxpayers time and money. Estimating total compliance costs is difficult because neither the government nor taxpayers maintain regular accounts of these costs and federal tax requirements often overlap with recordkeeping and reporting that taxpayers do for other purposes. Although available estimates are uncertain, taken together, they suggest that total compliance costs are large. For example, combining the lowest available estimates for the personal and corporate income tax yields a total of \$107 billion (roughly 1 percent of GDP) per year. As noted, whether this is a definitive lower bound for compliance costs is uncertain.

The tax system also results in economic efficiency costs because tax rules cause individuals to change their behavior in ways that ultimately leave them with lower-valued combinations of consumption and leisure than they would have obtained if the tax system did not affect their behavior. Estimating efficiency costs is very challenging because the tax system has such extensive and diverse effects on behavior. In fact, we found no comprehensive estimates of the efficiency costs of the current federal tax system. The two most comprehensive studies we found suggest that these costs are large—on the order of magnitude of 2 to 5 percent of GDP each year (as of the mid-1990s). However, the actual efficiency costs of the current tax system may not fall within this range because of uncertainty surrounding taxpayers' behavioral responses, changes in the tax code and the economy since the mid-1990s, and the fact that the two studies did not cover the full scope of efficiency costs.

The goal of tax policy is not to eliminate compliance and efficiency costs. The goal of tax policy is to design a tax system that produces the desired amount of revenue and balances the minimization of these costs with other objectives, such as equity, transparency, and administrability. In addition, whether compliance and efficiency costs could be reduced by redesigning the tax system and, if so, by how much would depend critically upon the detailed characteristics of the new tax system.

Components of the Total Cost of a Tax to Taxpayers



Source: GAO.

[www.gao.gov/cgi-bin/getrpt?GAO-05-878](http://www.gao.gov/cgi-bin/getrpt?GAO-05-878).

To view the full product, including the scope and methodology, click on the link above. For more information, contact James White at (202) 512-5594 or whitej@gao.gov.