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TAX GAP

IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources

GAO Highlights

Highlights of GAO-13-151, a report to congressional requesters

Why GAO Did This Study

Heightened attention to federal deficits has increased pressure on IRS to reduce the tax gap—the difference between taxes owed and taxes paid on time—and better enforce taxpayer compliance. Resource limitations and concern over taxpayer burden, however, prevent IRS from auditing more than a small fraction of individual income tax returns filed. How IRS allocates these limited resources demands careful consideration.

As requested, this report (1) describes how IRS allocates resources across individual taxpayer compliance enforcement programs and across types of taxpayers within each program; (2) estimates the direct revenue return on investment for the individual taxpayer enforcement programs and the extent of variation across those programs and across types of taxpayers; and (3) determines the potential for gains from shifting resources from lower-yielding programs and types of taxpayers to higher-yielding ones.

To accomplish these objectives GAO analyzed IRS data on 2007 and 2008 tax returns, reviewed IRS documentation, and interviewed appropriate IRS officials.

What GAO Recommends

GAO recommends that IRS review disparities in the ratios of direct revenue yield to costs across different enforcement programs and across different groups of cases and consider this evidence as a potential basis for adjusting its allocation of enforcement resources each year. IRS agreed with the recommendations.

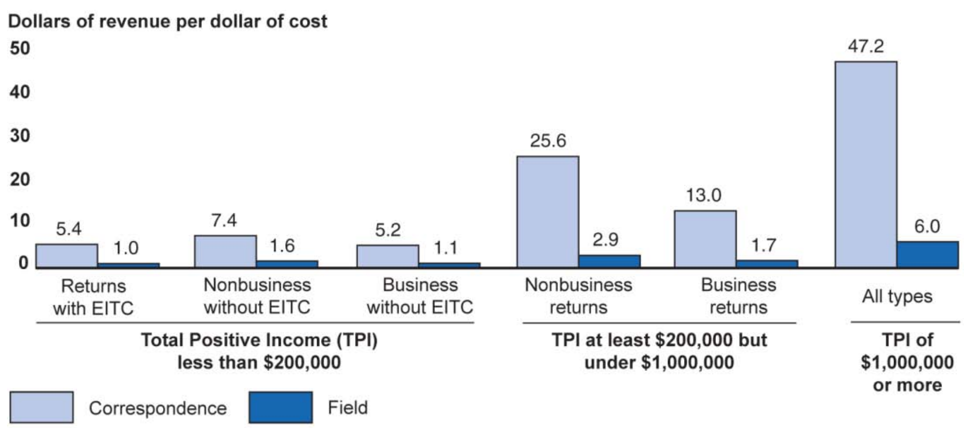
View GAO-13-151. For more information, contact James White at (202) 512-9110 or whitej@gao.gov

What GAO Found

The Internal Revenue Service (IRS) spends most of its enforcement resources on examinations. Correspondence exams of individual tax returns, which target fewer and simpler compliance issues, are significantly less costly on average than the broader and more complex field exams. GAO estimated that the average cost (including overhead) of correspondence exams opened in 2007 and 2008 was $274, compared to an average of $2,278 for field exams. IRS spent almost 20 percent of the $1.6 billion per year that it devoted to exams on returns from taxpayers with positive income of at least $200,000, even though such returns accounted for only 3 percent of the 136 million individual returns filed per year. (Positive income, a measure that IRS uses to classify returns for exam planning purposes, disregards losses that may offset this income).

GAO estimated that, for the 2 years of cases reviewed, correspondence exams were significantly more productive in terms of direct revenue produced per dollar of cost than field exams. As shown in the figure below, both types of exams of taxpayers with positive incomes of at least $200,000 were significantly more productive than exams of lower-income taxpayers.

Direct Revenue Return on Investment for Different Types of Exams and Groups of Individual Income Tax Returns Opened in 2007 and 2008



Source: GAO analysis of IRS data.

Note: EITC is the earned income tax credit

GAO demonstrated how these estimates could be used to inform resource allocation decisions. For example, a hypothetical shift of a small share of resources (about $124 million) from exams of tax returns in less productive groups shown in the figure to exams in the more productive groups could have increased direct revenue by $1 billion over the $5.5 billion per year IRS actually collected (as long as the average ratio of direct revenue to cost for each category of returns did not change). These gains would recur annually, relative to the revenue that IRS would collect if it did not change its resource allocation. This particular resource shift would not reduce exam coverage rates significantly and, therefore, should have little, if any, negative effect on voluntary compliance.