GAO Highlights

Highlights of GAO-24-106449, a report to the Ranking Member, Committee on Ways and Means, House of Representatives

May 2024

TAX GAP

IRS Should Take Steps to Ensure Continued Improvement in Estimates

Why GAO Did This Study

The tax gap—the difference between the tax amounts voluntarily paid by individuals and businesses and the tax amounts that are owed—has been a persistent problem for decades.

The tax gap is an aggregate estimate of individual income, corporation income, employment, and estate taxes. IRS estimates are based on three types of noncompliance: (1) underreporting of tax liabilities on timely filed tax returns; (2) underpayment of taxes due from timely filed returns; and (3) nonfiling, when a taxpayer fails to file a required tax return altogether or on time.

GAO was asked to review IRS's most recent tax gap estimates for tax years 2014-2016. This report (1) describes IRS's estimates and changes from prior estimates; (2) assesses IRS's changes to the sample design of NRP; and (3) assesses how the estimates help IRS and other stakeholders gain insights into noncompliance. GAO reviewed IRS's tax gap data and reports and interviewed IRS officials.

What GAO Recommends

GAO is making six recommendations to IRS, including that IRS conduct additional analyses to understand the root causes of undetected noncompliance and complete its documentation related to the pilot process for sampling returns.

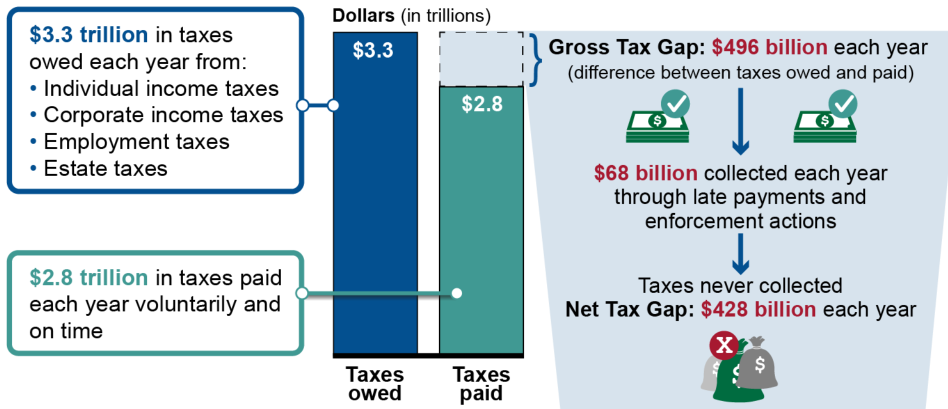
IRS agreed with all six of GAO's recommendations and described steps it plans to take in response to each recommendation.

View GAO-24-106449. For more information, contact James R. McTigue at (202) 512-6806 or McTigueJ@gao.gov.

What GAO Found

Taxpayers voluntarily and timely paid about 85 percent of the taxes they should have paid for tax years 2014-2016, according to the Internal Revenue Service's (IRS) latest tax gap estimate. IRS most recently projected the tax gap will grow to $688 billion for tax year 2021. However, when measured relative to the overall economy, the tax gap has remained relatively stable.

The Internal Revenue Service's Annual Average Tax Gap Estimate for Tax Years 2014-2016



Source: Internal Revenue Service (IRS). | GAO-24-106449

In developing the estimates, IRS applies a statistical technique to National Research Program (NRP) audit data to account for noncompliance that was not detected by examiners in audits. Applying this technique nearly doubles the individual underreporting tax gap estimate, increasing the estimate from $145 billion to $278 billion. IRS has not conducted analysis to understand the causes of this estimate of undetected noncompliance. By doing so, IRS would be better positioned to help improve the reliability of and confidence in the adjustment and potentially examiners' detection of noncompliance.

IRS is piloting a new process for sampling tax returns for NRP's audits. The new process uses artificial intelligence (AI) to improve the efficiency and selection of audit cases to help identify noncompliance. However, IRS has not completed its documentation of several elements of its AI sample selection models, such as key components and technical specifications. Completing documentation would help IRS retain organizational knowledge, ensure the models are implemented consistently, and make the process more transparent to future users.

IRS's Strategic Operating Plan (SOP) describes how IRS intends to spend the tens of billions of dollars it received under the Inflation Reduction Act. However, the SOP is not clearly linked to tax gap data. For example, the plan does not address sole proprietor noncompliance, which is one of the largest areas of tax noncompliance. Furthermore, IRS did not address a prior GAO recommendation to link NRP data to its compliance efforts. As IRS develops implementation plans for the SOP initiatives and projects, it has an opportunity to further integrate a significant source of evidence to refine its compliance strategies, thereby addressing the recommendation. Linking compliance strategies with data would help provide assurance that IRS is effectively allocating enforcement resources.