

The U.S. Tax Gap and Revenue Estimates From Increased Funding for the Internal Revenue Service

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U.S. Tax Gap

Estimates of the U.S. Tax Gap

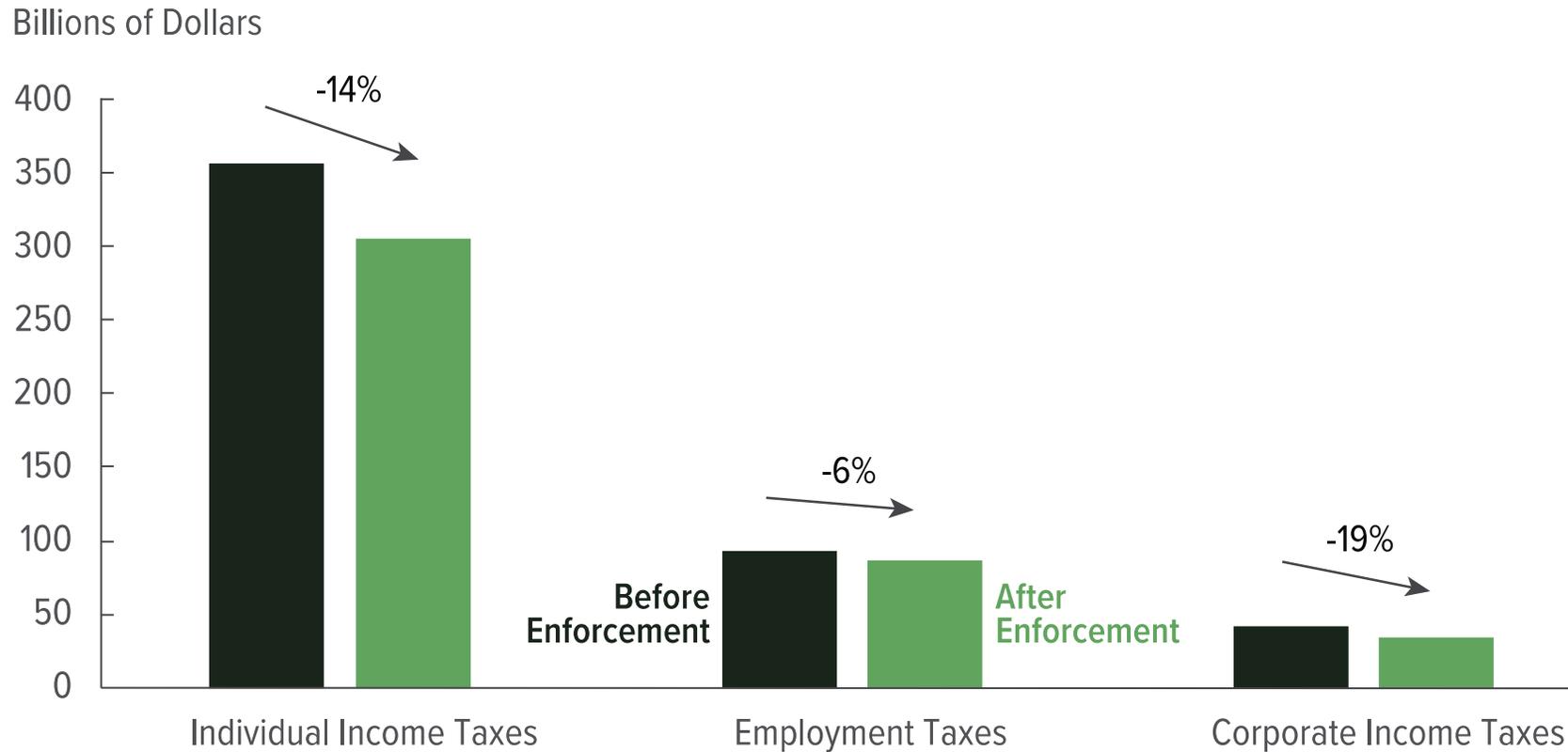
In the United States, the Internal Revenue Service (IRS) relies largely on taxpayers to report their income, calculate the amount of tax they owe, and remit that amount to the IRS through withholding or other payments.

The difference between the amount of taxes owed and the amount collected each year—often called the tax gap—is estimated periodically by the IRS.

- **Gross tax gap:** The difference between the total amount of federal taxes owed and the amount that taxpayers paid on or before the filing deadline.
- **Net tax gap:** The amount of taxes that remains unpaid after the IRS has sought to collect the taxes owed, through either administrative or enforcement actions.

Estimated Amount of Unpaid Taxes as an Annual Average, 2014 to 2016

Estimated Amount of Unpaid Taxes Before and After Enforcement



From 2014 to 2016, the gross tax gap averaged \$496 billion annually, the IRS estimates. That amount was 2.8 percent of U.S. gross domestic product and about 18 percent of federal taxes owed.

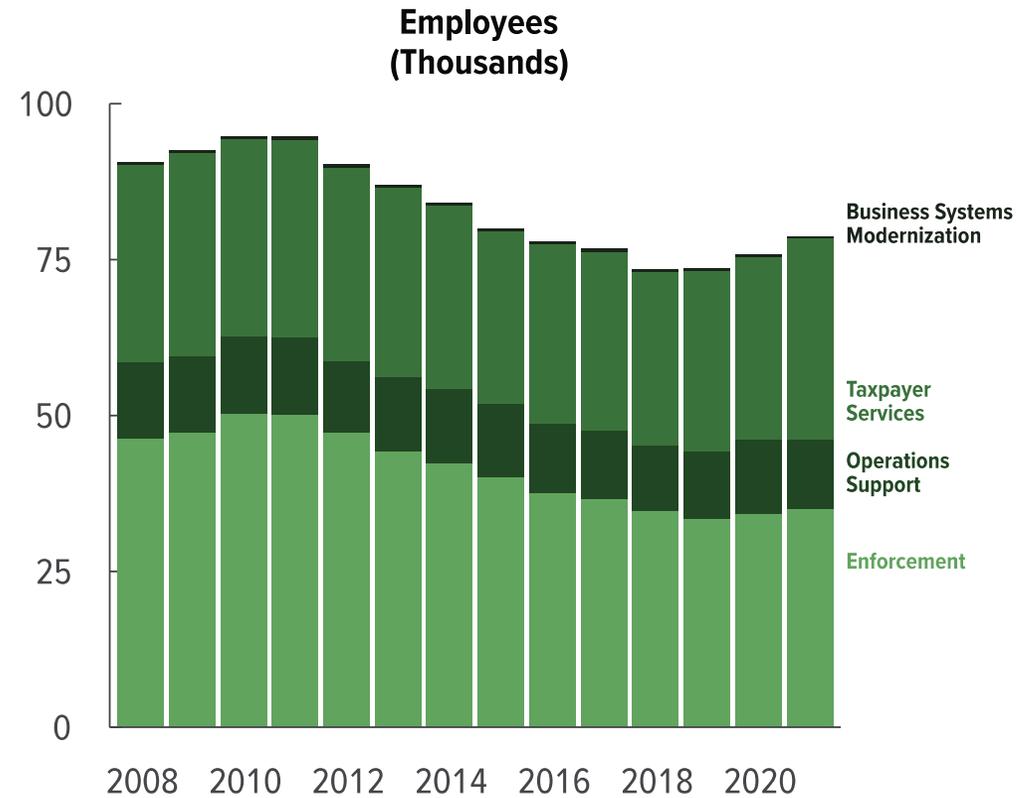
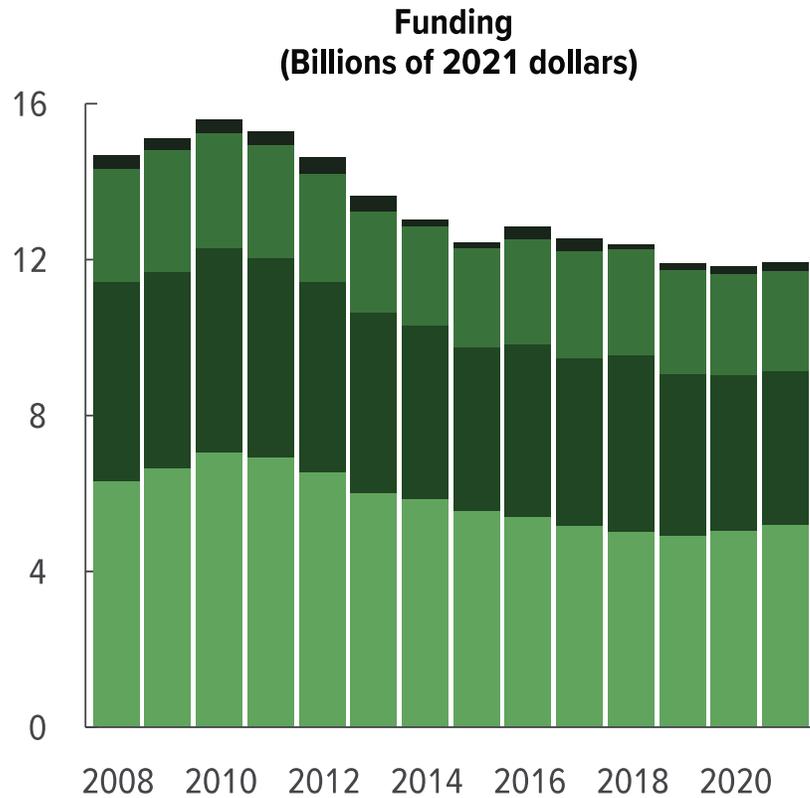
The net tax gap was an estimated \$428 billion annually over that period.



What Enforcement Actions Does the IRS Undertake?

- Identifying taxpayers who did not file returns on time and obtaining those returns
- Correcting mathematical or clerical errors
- Verifying information reported by taxpayers by checking it against information from third parties
- Using software to flag fraudulent or questionable refunds
- Collecting unpaid taxes through mailed notices, payment agreements with taxpayers, and liens or levies
- Auditing tax returns of corporations, partnerships, and individual taxpayers

Funding for the IRS and Number of Employees, by Appropriation Account, 2008 to 2021



Between 2008 and 2021, the IRS's appropriations decreased by 19 percent on an inflation-adjusted basis, and the number of employees fell by 13 percent.

The enforcement account absorbed much of that decline in staffing—dropping by 24 percent over that period.



How Changes in IRS Funding Would Affect Future Revenues

How CBO Estimates the Effects of Increased Funding

CBO's estimate of revenues is based on the IRS's projected returns on investment (ROIs) for spending on new enforcement initiatives.

CBO adjusts the ROIs to better reflect the marginal return on additional spending.

- CBO expects the IRS to prioritize the enforcement actions that it thinks will have the highest average return
- CBO expects taxpayers to adapt to the IRS's enforcement actions and adopt new ways of evading detection, so an enforcement activity may have a lower return in later years
- Productivity of the IRS's enforcement actions depends on the IRS's other capabilities (in terms of funding).

CBO's estimate of revenues also accounts for the timing of collections resulting from enforcement actions.

IRS Funding in the 2022 Reconciliation Act

Over the 2022–2031 period, that legislation increases total funding for the IRS by \$80 billion and funding for enforcement of tax laws by \$46 billion.

- Including that new funding, the IRS’s budget in 2031 is projected to be about one-tenth larger than it was in 2010 (its recent peak) when measured as a share of total output in the U.S. economy, CBO estimates

Revenues are projected to increase by \$180.4 billion over the 2022–2031 period.

- That estimate reflects the Secretary of the Treasury’s directive that the additional funding not be used to increase the share of small businesses or households with income below \$400,000 that are audited relative to historical levels.

Projected Changes in Spending and Revenues From Increased IRS Funding in the 2022 Reconciliation Act

By Fiscal Year, Millions of Dollars

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2022-2026	2022-2031
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Increases or Decreases (-) in Direct Spending

Subtitle A. Deficit Reduction

Part 3. Funding the Internal Revenue Service and Improving Taxpayer Compliance

Sec. 10301 Enhancement of Internal Revenue Service

Resources

Budget Authority	79,622	0	0	0	0	0	0	0	0	0	79,622	79,622
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Estimated Outlays	0	3,823	3,380	4,970	6,248	7,996	10,106	12,617	15,072	15,388	18,421	79,600
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Memorandum:

Nonscorable Increases in Revenues

Enhancement of Internal Revenue Service

Resources	0	2,012	5,106	11,125	16,116	21,716	26,314	31,218	34,877	31,904	34,359	180,388
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Resources for Additional Information

Congressional Budget Office, *Estimated Revenue Effects of Increased Funding for the Internal Revenue Service in H.R. 5376, the Build Back Better Act* (November 2021), www.cbo.gov/publication/57620

Congressional Budget Office, “The Effects of Increased Funding for the IRS,” *CBO Blog* (September 2, 2021), www.cbo.gov/publication/57444

Congressional Budget Office, *Trends in the Internal Revenue Service’s Funding and Enforcement* (July 2020), www.cbo.gov/publication/56422

Internal Revenue Service, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014–2016* (October 2022), www.irs.gov/pub/irs-pdf/p1415.pdf