



**G A O**  
Accountability \* Integrity \* Reliability

---

**United States Government Accountability Office**  
**Washington, DC 20548**

**GAO Work on Efforts to Reduce Tax Evasion and Tax Fraud**  
**Prepared for the Internal Revenue Service Oversight Board Public Meeting**  
**May 1, 2013**

In January 2012, the Internal Revenue Service (IRS) estimated that the gross tax gap—the difference between taxes owed and taxes paid on time—was \$450 billion in tax year 2006. IRS estimated that it would eventually recover about \$65 billion of this amount through late payments and enforcement actions, leaving a net tax gap of \$385 billion. The tax gap has been a persistent problem in spite of a myriad of congressional and IRS efforts to reduce it, as the rate at which taxpayers voluntarily comply with United States tax laws has changed little over the past three decades. Because noncompliance has multiple causes and spans different types of taxes and taxpayers, multiple approaches are needed to reduce the tax gap. GAO's work has identified various measures that IRS and Congress could take to improve taxpayer compliance and reduce the tax gap.

### **Enhancing Information Reporting to IRS by Third Parties**

Information reporting is a powerful tool that reduces tax evasion and helps taxpayers comply voluntarily, as taxpayers are much more likely to report their income accurately when the income is also reported to IRS by a third party. By matching information received from third-party payers with what payees report on their tax returns, IRS can detect income underreporting, including the failure to file a tax return. GAO has suggested Congress consider expanding information reporting by requiring reporting for (1) service payments to corporations and (2) service payments made by landlords. Broader requirements for these two forms of information reporting, covering goods in addition to services, were enacted into law in 2010 but were later repealed. We believe the more narrow extensions of information reporting to include services, but not goods, remain important options for improving compliance.

Additionally, we recommended that IRS enhance existing information reporting requirements by

- revising the form (1098-T) on which educational institutions report information on tuition and related expenses for higher education that qualify for tax deductions or credits, and
- requiring third parties, such as mortgage lenders, to report mortgaged property addresses in addition to information they are already required to report on mortgaged properties.

IRS agreed to consider revising Form 1098-T, but has not made any revisions to date. IRS studied requiring property address to be reported with other information already required for

mortgaged properties but concluded that this change would not be worth the cost. GAO maintains that this change would be beneficial.

### Related Reports

*Tax Administration: Expanded Information Reporting Could Help IRS Address Compliance Challenges with Forgiven Mortgage Debt.* GAO-10-997. Washington, D.C.: August 31, 2010

*2009 Tax Filing Season: IRS Met Many 2009 Goals, but Telephone Access Remained Low, and Taxpayer Service and Enforcement Could Be Improved.* GAO-10-225. Washington, D.C.: December 10, 2009

*Home Mortgage Interest Deduction: Despite Challenges Presented by Complex Tax Rules, IRS Could Enhance Enforcement and Guidance.* GAO-09-769. Washington, D.C.: July 29, 2009

*Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements.* GAO-09-238. Washington, D.C.: January 28, 2009

*Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance.* GAO-08-956. Washington, D.C.: August 28, 2008

### **Leveraging Paid Tax Return Preparers**

As paid preparers prepare approximately 60 percent of all tax returns filed, their actions have an enormous impact on IRS's ability to administer tax laws effectively. Based in part on our work and recommendations, in 2010 IRS developed new requirements for paid preparers, such as competency testing, which it has concluded will increase tax compliance. IRS is appealing a decision by a U.S. District Court to enjoin IRS from enforcing the new requirements. Regardless of the outcome of the appeal, it is critical for IRS to seek ways to leverage paid preparers to improve tax compliance.

### Related Reports

*Tax Preparer Regulation: IRS Needs a Documented Framework to Achieve Goal of Improving Taxpayer Compliance.* GAO-11-336. Washington, D.C.: March 31, 2011

*Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation.* GAO-08-781. Washington, D.C.: August 15, 2008

*Internal Revenue Service: Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season.* GAO-08-567. Washington, D.C.: March. 13, 2008

### **Expanding Compliance Checks Before IRS Issues Refunds**

During 2012, IRS began to match wage and tax withholding data reported on information returns, such as Form W-2, to tax returns in March rather than later in the spring or summer after the tax return filing season. IRS is exploring the possibility of more extensive matching of

information and tax returns before issuing tax refunds. IRS is considering the implications that expanding earlier matching could have for taxpayer and compliance and tax administration efficiency. This approach could also help IRS address identity theft-related fraud.

#### Related Reports

*Identity Theft: Total Extent of Refund Fraud Using Stolen Identities is Unknown.* GAO-13-132T. Washington, D.C.: November 29, 2012

*Tax Refunds: Enhanced Prerefund Compliance Checks Could Yield Significant Benefits.* GAO-11-691T. Washington, D.C.: May 25, 2011

#### **Addressing Offshore Tax Noncompliance**

Given the mobility of money and proliferation of foreign financial institutions, the potential for U.S. taxpayers to evade taxes on funds held in offshore accounts is greater than ever. Likewise, foreign-source income presents a variety of compliance challenges related to the complex structure of multinational corporations, transfer pricing, and the taxation of intangible property. IRS has implemented various programs designed to entice taxpayers to voluntarily disclose their offshore accounts. Likewise, IRS is implementing recently enacted requirements related to financial institutions and taxpayers reporting to IRS on certain offshore accounts and assets of U.S. account holders. As it continues to implement its voluntary disclosure efforts and strategies for using information received on offshore accounts, IRS may be able to further its efforts to ensure offshore tax compliance. IRS agreed with GAO's recommendation to develop a strategy for using information it obtains on foreign accounts to improve tax compliance, but has yet to implement it.

#### Related Reports

*Foreign Account Reporting Requirements: IRS Needs to Further Develop Risk, Compliance, and Cost Plans.* GAO-12-484. Washington, D.C.: April 16, 2012

*International Taxation: Study Countries That Exempt Foreign-Source Income Face Compliance Risks and Burdens Similar to Those in the United States.* Washington, D.C.: GAO-09-934. September 15, 2009

*Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS.* GAO-09-478T. Washington, D.C.: March 17, 2009

*U.S. Multinational Corporations: Effective Tax Rates Are Correlated with Where Income Is Reported.* GAO-08-950. Washington, D.C.: August 12, 2008

## **Allocating Enforcement Resources Based on Return-on-Investment Measures**

Making more effective use of available resources can help IRS mitigate the impact of shrinking budgets and increased responsibilities on its taxpayer service and enforcement efforts. Using direct revenue return-on-investment (ROI) measures of its enforcement programs could help IRS better target its enforcement resources and help maximize income tax collections. For example, in a recent analysis, GAO found that using ROI to make modest reallocations of IRS's enforcement resources could raise billions of dollars in direct revenue with little, if any, resulting decline in voluntary compliance. GAO recommended 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 recommendation but has yet to implement it.

### Related Reports

*Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources.* GAO-13-151. Washington, D.C.: December 5, 2012

*IRS 2013 Budget: Continuing to Improve Information on Program Costs and Results Could Aid in Resource Decision Making.* GAO-12-603. Washington, D.C.: June 8, 2012

*Internal Revenue Service: Assessment of Budget Justification for Fiscal Year 2011 Identified Opportunities to Enhance Transparency.* GAO-10-687R. Washington, D.C.: May 26, 2010

## **Addressing Business Noncompliance**

Nearly 40 percent of the tax gap can be attributed to underreporting of business income by individuals, such as those with income from sole proprietorships, S corporations, and partnerships. Further, misreporting of non-corporate business income tax can be largely attributed to sole proprietors who understated receipts or overstated expenses. A key reason for this underreporting is the limited information reporting covering sole proprietor income. Likewise, taxpayers can control a group of related entities—such as corporations or partnerships—in a network. These networks can serve a variety of legitimate business purposes, but can be used in tax evasion schemes that are difficult for IRS to identify. Some actions GAO found that could improve compliance in this area include (1) Congress requiring S corporations to report shareholder basis to IRS and shareholders, (2) the Department of the Treasury ensuring that its strategy to address the tax gap that covers sole proprietor compliance in detail, and (3) IRS developing strategies for addressing tax evasion among networks of related entities. Congress has not enacted legislation to require S corporation basis reporting. Treasury's strategy to

address the tax gap does not cover sole proprietor compliance in detail. IRS agreed with the recommendation to develop a strategy for addressing tax evasion among networks of related entities but has yet to implement it.

#### Related Reports

*Abusive Tax Avoidance Transactions: IRS Needs Better Data to Inform Decisions about Transactions.* GAO-11-493. Washington, D.C.: May 12, 2011

*Tax Gap: IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related Entities.* GAO-10-968. Washington, D.C.: September 24, 2010

*Tax Gap: IRS Has Modernized Its Business Nonfiler Program but Could Benefit from More Evaluation and Use of Third-Party Data.* GAO-10-950. Washington, D.C.: August 31, 2010

*Tax Gap: Actions Needed to Address Noncompliance with S Corporation Tax Rules.* GAO-10-195. Washington, D.C.: December 15, 2009

*Tax Gap: Limiting Sole Proprietor Loss Deductions Could Improve Compliance but Would Also Limit Some Legitimate Losses.* GAO-09-815. Washington, D.C.: September 10, 2009

*Tax Gap: A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance.* GAO-07-1014. Washington, D.C.: July 13, 2007

#### **Simplifying the Tax Code**

Tax code complexity can cause taxpayer confusion and provide opportunities to hide willful noncompliance. Fundamental tax reform could result in improved tax compliance if the new system has fewer tax preferences or complex tax code provisions, reducing IRS's enforcement challenges and increasing public confidence in the fairness of the tax system. Short of fundamental reform, targeted simplification opportunities exist, such as changing tax laws to include more consistent definitions across tax provisions.

#### Related Reports

*Tax Expenditures: Background and Evaluation Criteria and Questions.* GAO-13-167SP. Washington, D.C.: November 29, 2012

*Higher Education: Improved Tax Information Could Help Pay for College.* GAO-12-863T. Washington, D.C.: July 25, 2012

*Tax Gap: Sources of Noncompliance and Strategies to Reduce It.* GAO-12-651T. Washington, D.C.: April 19, 2012

*Financial Derivatives: Disparate Tax Treatment and Information Gaps Create Uncertainty and Potential Abuse.* GAO-11-750. Washington, D.C.: September 20, 2011

*Tax Policy: The Research Tax Credit's Design and Administration Can Be Improved.* GAO-10-136. Washington, D.C.: November 6, 2009

*Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined.* GAO-05-690. Washington, D.C.: September 23, 2005

*Understanding the Tax Reform Debate: Background, Criteria, and Questions.* GAO-05-1009SP. Washington, D.C.: September 2005