

IT'S TIME TO DO SOMETHING ABOUT THE TAX GAP

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I. INTRODUCTION

What do the weather and the tax gap have in common? People talk about them, but nobody does anything about them. When it comes to the tax gap, the articles keep on coming. In August of 2007, the Internal Revenue Service (“IRS”) released a 98 page report on the tax gap.¹ This one, “A Report on Improving Voluntary Compliance”,² probably does not add much to the volumes of articles already out there. It is not just the IRS that keeps on writing about the tax gap. Just one month earlier the Government Accountability Office (“GAO”) issued its own extensive tax gap report, “TAX GAP, A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance.”³

Instead of researching and writing more reports, why doesn’t the IRS make an all out assault on the tax gap? This article will try to demonstrate that enough has been written and that it is time to act. The tax gap will never be entirely closed, but it will not even be substantially reduced until the IRS acts to close the gap, rather than allocate its resources to information gathering and report-writing.

II. USE OF THE TERM “TAX GAP”

When the use of the term “tax gap” began is not very easy to pinpoint. The use of the term appears to have started in the early 1980s. In 1982, IRS Commissioner Roscoe L. Egger Jr. stated that the IRS “projections are that the legal tax gap will continue to increase, if no improvements [in tax collections] are made, and will reach \$100 billion in 1985.”⁴ IRS Commissioner Lawrence B. Gibbs seemed to talk about the tax gap, but did not use that term, when he stated “we knew there were major information gaps about noncompliance.”⁵ In 1988, the IRS noted

1. INTERNAL REVENUE SERVICE AND DEPARTMENT OF THE TREASURY, REDUCING THE FEDERAL TAX GAP: A REPORT ON IMPROVING VOLUNTARY COMPLIANCE (Aug. 2007), http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf (last visited Oct. 5, 2008).

2. *See id.*

3. UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, REPORT TO THE COMMITTEE ON FINANCE, U.S. SENATE: A STRATEGY FOR REDUCING THE GAP SHOULD INCLUDE OPTIONS FOR ADDRESSING SOLE PROPRIETOR NONCOMPLIANCE (JULY 2007), <http://www.gao.gov/new.items/d071014.pdf>.

4. *The Underground Economy’s Hidden Force*, BUS. WK., Apr. 5, 1982, at 64.

5. Lawrence B. Gibbs, Comm’r of Internal Revenue, Remarks at the American Bar Association Invitational Conference on Income Tax Compliance (Apr. 15, 1988).

that there are two components to the tax gap: “the tax liability reporting gap and the tax remittance gap.”⁶

It appears that the term “tax gap” was first used in a law review article in 1983.⁷ “Tax gap” then made its way into a Newsweek article in 1984.⁸ The article states that “tax cheating is on the rise: the so-called ‘tax gap,’ or difference between what taxpayers owe and actually pay, is running to nearly \$100 billion, a 226% increase since 1973.”⁹

“Tax gap” as a defined term is used by almost everyone. A LexisNexis Academic search for 2007 found more than 112 headlines that included “Tax Gap” and that was in just one daily tax publication, *Tax Notes Today*.¹⁰ The term is so well understood that a Kiplinger tax letter did not feel it needed to define the term. The letter simply said, “In their 2008 budget, Senate Democrats plan to raise \$900 billion in revenue, largely from unspecified proposals to close the tax gap. But Republicans warn of dire consequences for law-abiding taxpayers.”¹¹

III. PUBLIC COMMENTS

In 2005, Senator Max Baucus stated the following: “Not closing the Tax Gap – that is, not collecting the taxes that are owed, is akin to looking the other way when there’s shoplifting going on . . . People have been talking about the Tax Gap for decades. It is time to stop talking and start doing something about it. . . .”¹² As part of the same Senate hearing Senator Charles E. Grassley said, “[t]he tax gap is a \$350 billion dollar problem, and we are all working hard to find solutions for the American taxpayer.”¹³

6. IRS Publications, *Income Tax Compliance Research: Gross Tax Gap Estimates and Projections for 1973–1992*, 88 TNT 61-35, Mar. 14, 1988.

7. See James S. Henry, *Noncompliance With U.S. Tax Law—Evidence on Size, Growth and Composition*, 37 TAX L.J. 1, 1983.

8. See Susan Dentzer, Rich Thomas & Gloria Borger, *The Tax Maze: Time to Start Over?*, NEWSWEEK, Apr. 16, 1984, at 62.

9. *Id.*

10. The search terms were “headline(tax w/1 gap)” and “tax w/1 notes w/1 today” with the search limited to those documents after December 31, 2006.

11. Kiplinger Tax Letter, *Fixing the Tax Gap*, March 23, 2007, available at 2007 WLNR 5667555.

12. Senator Max Baucus, Statement at U.S. Committee on Finance Hearing: The \$350 Billion Question: How to Solve the Tax Gap, Apr. 14, 2005, available at <http://www.senate.gov/~finance/hearings/statements/041405cg.pdf>.

13. Senator Chuck Grassley, Chairman, Statement at U.S. Committee on Finance Hearing: The \$350 Billion Question: How to Solve the Tax Gap, Apr. 14, 2005, available at <http://www.senate.gov/~finance/hearings/statements/041405mb.pdf>.

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One year earlier Senator Baucus “called for a 90 percent voluntary compliance rate by the year 2010.”¹⁴ The press release indicated that 15% of people “are failing to live up to their tax obligations.”¹⁵ The release estimated that the increased compliance would raise \$100 billion each year.¹⁶ The Senator also scolded the executive branch, saying, “I urge the administration and Commissioner Everson to re-examine the budget that you have put forward. The bottom line is that you did not ask for the resources that are necessary to do the enforcement, taxpayer service, and modernization that are required in order to close the Tax Gap.”¹⁷

Senator Grassley said that “in spite of the IRS’ efforts to improve taxpayer compliance, the rate of voluntary, timely payment has ranged from around 81% to around 84% over the past 30 years.”¹⁸ However, after almost 30 years of continued efforts by the IRS, Senator Coburn stated last year that “we don’t know the size of, scope of, and reasons for the problem. Either the IRS must find a way to develop a more precise picture of where money is being lost, or Congress better get moving on fundamentally revamping the tax code.”¹⁹

Not everyone thinks that the tax gap is a big problem or that new laws and penalties are the solution. A Cato Institute Bulletin suggests that raising taxes also raises noncompliance and that stricter laws may create privacy concerns.²⁰ A similar bulletin points out that the “United States has the smallest shadow economy of 145 nations analyzed.”²¹

14. Press Release, S. Comm. on Fin., Baucus Calls for 90 Percent Voluntary Tax Compliance by 2010 (Apr. 13, 2004), *available at* <http://finance.senate.gov/press/Bpress/2004press/prg041304.pdf>.

15. *Id.*

16. *Id.*

17. Press Release, S. Comm. on Finance, The \$350 Billion Question: How to Solve the Tax Gap (Apr. 14, 2005) *available at* <http://www.senate.gov/~finance/hearings/statements/041405cg.pdf>. Does anyone believe that if the Commissioner had asked for a budget large enough to close the tax gap that Congress would have approved it or that the President would have signed that budget into law?

18. Press Release, S. Comm. on Finance, Baucus, Grassley Visit IRS to Get Tax Gap Answers (Jan. 30, 2007), *available at* http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=13077.

19. Senator Tom Coburn, Chairman, Deconstructing the Tax Code: Uncollected Taxes and Issues of Transparency (Sept. 26, 2006), *available at* http://coburn.senate.gov/ffm/index.cfm?FuseAction=Files.View&FileStore_id=e0d33267-9944-47c1-9898-74ca58914899.

20. See Chris Edwards, *Income Tax Rife with Complexity and Inefficiency*, 33 CATO INST. TAX & BUDGET BULLETIN 1 (2006).

21. Daniel Mitchell, *The Tax Gap Mirage*, 44 CATO INST. TAX & BUDGET BULLETIN 1 (2007).

IV. IS THE PROBLEM ONE OF IDENTIFICATION?

There are many causes of the tax gap, including non-filers, under reported income, overstated deductions, tax shelters, offshore trusts, and unpaid taxes such as income, employment, excise and gasoline taxes, just to name a few.²² It must be a significant problem as even the Pope thinks tax evasion in Italy, caused primarily by the use of offshore trusts, needs to be curtailed.²³ Why is it so hard to find these taxpayers? One reason is that unlike criminal prosecutions, which often begin with a known crime such as a reported theft, the IRS often is unaware of the problem until it performs an audit.²⁴ And who should they audit?

The latest estimate of the tax gap, broken down by categories is:

	Billion \$	%
Underreporting	197	57.1%
Underpayment	23	6.7%
Nonfiling	25	7.2%
Corporate	32	9.3%
Payroll	59	17.1%
Other	9	2.6%
Total ²⁵	345	

Identifying the wayward taxpayer is a difficult job requiring a great deal of investigation.²⁶ The IRS would need untold billions of dollars added to its budget to identify all of those who are cheating.²⁷ But, what if they already have leads that might only require a simple letter and some minimal follow up? One would expect the IRS to pursue all of those leads. Unfortunately

22. *Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap: Hearing Before S. Comm. on the Budget*, 110th Cong. 3-4 (Jan. 2007)(statement of Michael Brostek, Tax Issues Strategic Team), available at <http://www.gao.gov/new.items/d07391t.pdf>.

23. Web CPA Staff, *Pope to Denounce Tax Evasion*, WEB CPA ONLINE, Aug. 20, 2007, <http://www.webcpa.com/article.cfm?articleid=25103>.

24. Brostek, *supra* note 22, at 16.

25. JASON FURMAN, CTR. ON BUDGET & POLICY PRIORITIES, CLOSING THE TAX GAP 2 (Apr. 2006), www.cbpp.org/4-10-6tax3.pdf.

26. *See generally id.* (drawing upon an explanation of the sources of the tax gap and steps to close it).

27. *Id.* at 3.

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for the tax gap, that is not the case.²⁸ One report says that the IRS already knows at least 10 million taxpayers who potentially owe billions of dollars, and yet the IRS does nothing:

[The] IRS estimated that it contacted about 3 million of the over 13 million taxpayers it identified as potentially noncompliant through its matching of tax returns to information returns. IRS estimated that contacting the additional 10 million potentially noncompliant taxpayers it identified, at a cost of about \$230 million, could yield nearly \$7 billion in potentially collectible revenue.²⁹

Who knew that the IRS already had a list of 10 million taxpayers on which it could easily follow up? With a cost of only \$230 million (out of a total budget of over \$10 billion), is the failure to implement this program really a budget issue? If it is a budget issue, did Senator Baucus not say to just ask for the money? The failure of the IRS to contact 10 out of 13 “non-filer” leads represents a failure rate of over 75%.³⁰ What message is being sent to those 7.5 million taxpayers who know that they received interest on their savings account but also know that it was reported to the IRS who never asked why they failed to report the income on their tax returns? You don’t need a degree in psychology to figure that one out!

Recently, the IRS stated that it had sent “soft notices” to 500 taxpayers telling them that the IRS had information that they had not reported all of their income.³¹ According to the IRS the response by taxpayers was 100%, simply due to responses from receiving the soft notice letter.³² Due to their success, the IRS followed up the next year by sending out 2,500 notices; this year, the soft notice program is on hiatus but there will be a much larger mailing in 2009.³³

A GAO report addresses soft notices and says that the IRS has sent out many of these notices:

28. See *Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap: Hearing Before S. Comm. on the Budget*, 110th Cong. 16 (Jan. 2007) (statement of Michael Brostek, Director, Tax Issues Strategic Team), available at <http://www.gao.gov/new.items/d07391t.pdf>.

29. *Id.* at 17.

30. Dividing 10 by 13 produces a rate of 76.9%.

31. Sam Young, *IRS Officials Discuss ‘Soft Notice’ Compliance Program*, *Electronic Tax Administration*, 2007 TNT 217-7, Nov. 7, 2007, at 2 (quoting Richard Morgante, Wage & Investment Comm’r).

32. *Id.*

33. *Id.*

[I]n 1998, IRS's underreporter program identified almost 12 million taxpayers whose reported income on tax returns did not match income reported by payers, but the IRS contacted fewer than 2 million of these taxpayers about the discrepancies. Ten million cases were excluded for such reasons as the discrepancy being less than the IRS's minimum tolerance amount and the IRS not having the resources available to review returns and respond to taxpayer questions.³⁴

The reason always seems to be lack of resources. As one IRS Commissioner explained:

[T]he IRS is committed to ensuring everyone pays his or her fair share, including those who have the resources to move money offshore. . . . Honest taxpayers should not bear the burden of others who skirt their responsibility. It's as simple as this. Taxpayers should pay what they owe. However, the poaching of enforcement personnel to bolster customer service contributed to a steady and disturbing decline in enforcement. . . . [T]he GAO identified the collection of unpaid taxes as a major and growing management challenge as reflected in the large and pervasive declines in IRS's compliance and collection programs.³⁵

V. CALCULATING THE EXTENT OF THE PROBLEM

Many of the official releases regarding the tax gap list the dollar amounts involved. These releases sometimes try to break down the total amounts based on types of tax avoidance or types of returns. What they never seem to do is say whether the

34. U.S. GOV'T ACCOUNTABILITY OFFICE, IRS' USE OF NON-AUDIT CONTACTS, at 6 (2000). There were even more notices for social security numbers, dependents, etc. *Id.* at 22. So, it is hard to see why a study of 500 taxpayers was needed to see if this works.

35. Mark W. Everson, Commissioner of Internal Revenue Service, Testimony before the Annual Joint Review Progress Report on the IRS Restructuring and Reform Act of 1998 (May 20, 2003), at 10, *available at* http://www.irs.gov/pub/irs-utl/rra98_joint_review_final_written.pdf. Several years later, the goal of stopping offshore transfers may not be as important as it once was. See Edmund L. Andrews, *IRS Curtails Many Audits in Tax Havens*, N.Y. TIMES, May 3, 2007, at 1, *available at* http://www.nytimes.com/2007/05/03/business/03tax.html?_r=1&oref=slogin. Furthermore, "the I.R.S. reported that almost \$300 billion in investment and business income was moved out of the United States in 2003. Analysts at the Joint Committee on Taxation have estimated that the annual outflow has shot to more than \$400 billion since then." *Id.*

overall increase is the result of inflation or if it is the result of more aggressive actions by taxpayers. As seen below, the numbers vary depending on the source, but the dollar amounts continue to increase.

A. *Basis for Tax Gap Estimates – TCMP Audits*

Voluntary compliance levels and the tax gap projects are based largely on Taxpayer Compliance Measurement Program (“TCMP”) audits which began in 1963.³⁶ Individual surveys exist for 1963, 1965, 1969, 1971, 1973, 1976, 1979, 1985, and 1988, and that initial examination consisted of 92,000 individual returns.³⁷ The last full study occurred in 2001.³⁸ Results from that study did not come out until 2006.³⁹

One article described the death of the TCMP audit and the nature of the current tax gap estimates as follows:

The IRS had planned on carrying out a new TCMP survey in 1995. It was to have been the largest ever conducted. Unfortunately for tax compliance, the Republicans unexpectedly won control of both Houses of Congress in the 1994 elections and because of its cost, and unpopularity with taxpayer’s audited, the TCMP was suspended indefinitely just before it was about to begin. In spite of the lack of new TCMP data, the IRS continues to release tax gap data based upon the 1988 TCMP updated only to reflect the changing composition of taxable income. Because of the disadvantages of these two direct methods (surveys and tax auditing) of measuring the size of the underground economy, most researchers have used indirect methods to measure the size of the

36. Wendy Rotz, Jeri Mulrow, & Eric Falk, Internal Revenue Service, *The 1995 Taxpayer Compliance Measurement Program (TCMP) Sample Redesign-A Case History*, at 699, available at http://www.amstat.org/sections/SRMS/Proceedings/papers/1994_119.pdf (last visited Nov. 15, 2008). See also *IRS Can Use Tax Gap Data to Improve Its Programs for Reducing Noncompliance: Hearing Before the H. Subcomm. on Oversight*, 101st Cong. 6 (1990) (statement of Paul L. Posner, Assoc. Dir., Tax Policy and Admin. Issues, U.S. Gen. Accounting Office), available at <http://archive.gao.gov/t2pbat11/141156.pdf>.

37. Wendy Rotz, Jeri Mulrow, & Eric Falk, Internal Revenue Service, *The 1995 Taxpayer Compliance Measurement Program (TCMP) Sample Redesign-A Case History*, at 699, available at http://www.amstat.org/sections/SRMS/Proceedings/papers/1994_119.pdf (last visited Nov. 15, 2008).

38. Dustin Stamper, *IRS Beginning New Tax Gap Study*, TAX NOTES, June 11, 2007, at 986.

39. *Id.*

underground economy in countries around the world. Basically, these approaches rely upon inferring the level or trends in noncompliance from data on measurable quantities, such as currency demand and national income and product accounts, that might be related in some known way to the size of the underground economy.⁴⁰

Given the vast amount of information already obtained by previous TCMP audits, one would think that the IRS would adjust its current audit approach to the known problem areas and therefore at least put a dent in the tax gap.

According to the GAO however, the “IRS generally does not design its major enforcement programs to specifically pursue components of the tax gap. With some limited exceptions, these programs address noncompliance in a general way by focusing on the types of tax returns, rather than the type of noncompliance.”⁴¹ According to a Treasury Inspector General for Tax Administration (“TIGTA”) memorandum in 2006, the benefit of the TCMP audit information has not been realized:

Despite actions the IRS has taken to improve its enforcement efforts, TIGTA continues its designation of tax compliance initiatives as a major management challenge for the IRS. . . . TIGTA’s evaluation of the reliability of the IRS-developed tax gap figures concluded that the IRS still does not have sufficient information to completely and accurately assess the overall tax gap and voluntary compliance. The IRS has significant challenges in both obtaining complete and timely data, and developing the methods for interpreting the data.⁴²

40. Neil Brooks, Presentation at Asian Development Bank 2001 Tax Conference, Key Issues in Income Tax: Challenges of Tax Administration and Compliance (Sept. 8, 2001), at 10, *available at* http://www.adb.org/Documents/Events/2001/Tax_Conference/paper_brooks.pdf.

41. *IRS Can Use Tax Gap Data to Improve Its Programs for Reducing Noncompliance: Hearing Before the H. Subcomm. on Oversight*, 101st Cong. 6 (1990) (statement of Paul L. Posner, Assoc. Dir., Tax Policy and Admin. Issues, U.S. Gen. Accounting Office), *available at* <http://archive.gao.gov/t2pbat11/141156.pdf>.

42. Memorandum from J. Russell George, Inspector Gen. for Tax Admin., U.S. Dep’t of the Treasury, to Henry Paulson, Secretary, U.S. Dep’t of the Treasury 2 (Oct. 2, 2006), *available at* http://www.treas.gov/tigta/management/management_fy2007.pdf.

B. *Estimating the Tax Gap*

Reliable and consistent information about the tax gap is hard to come by. The following are some public estimates:

- 1973 - The estimate of unpaid taxes on legal activities—what was then called the “underground economy”—was only \$29 billion in 1973.⁴³
- 1981 - The Commissioner said that it had tripled to \$87 billion in 1981.⁴⁴ Another estimate for 1981 was \$75.9 billion.⁴⁵ It said that the underground economy accounted for “only” 10.5% of the 1981 total.⁴⁶
- 1987 - The estimate of \$103 billion was projected to grow to \$200 billion by 1992.⁴⁷
- 1994 - The estimate was projected to be \$150 billion.⁴⁸ At that time it appeared that at least a portion of the increase may have been due to the fact that only 1% of the individual returns were being audited compared to 5% in the 1960s.⁴⁹ The article noted that the IRS was undertaking computer modernization that was supposed to save the government \$4.8 billion.⁵⁰
- 1998 - The estimate was \$195 billion.⁵¹ This “was extrapolated from a 1998 study on unpaid taxes.”⁵² The IRS spokesman said that this was nearly double the 1992 estimate of \$100 billion and

43. Edward Cowan, *Tax-Enforcement Bill Gets Support*, N.Y. TIMES, May 19, 1982, at D1.

44. *Id.*

45. Edward Cowan, *Bill Aimed at Closing ‘Tax Gap’*, N.Y. TIMES, May 17, 1982, at D1.

46. *Id.*

47. *Plan to Shrink U.S. Tax Gap*, N.Y. TIMES, May 8, 1987, at D13.

48. Mitchell Zuckoff & Randolph Ryan, *IRS Plays David, but Business Goliath Wins*, BOSTON GLOBE, Apr. 11, 1994, at 8.

49. *Id.*

50. *Id.*

51. *Estimate of Unpaid Taxes Has Doubled*, ST. LOUIS POST-DISPATCH, May 12, 1998, at C14.

52. *Id.*

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much greater than the 1987 estimate of \$71 billion.⁵³

• 2001 - The estimate was \$345 billion made up in part by under reporting of business income of \$148 billion of which \$39 billion was for Social Security and Medicare taxes.⁵⁴

Current numbers do not appear to be available.⁵⁵ These same numbers are still being used today.⁵⁶

VI. GAO AND THE TAX GAP

Not only the IRS has written tax gap reports. Others seem to like the subject, and they have not been shy about writing their own reports detailing the problem and often suggesting solutions.⁵⁷ The GAO has done its share of investigating the tax gap.⁵⁸ A March 17, 1982 statement discussed issues that read like current tax gap statements and said that IRS resources have not kept pace as a result of too many returns, not enough resources and complicated tax laws. It included numerous recommendations to both Congress and the IRS for improvements.⁵⁹

It appears that the GAO started calling this problem the “tax gap” in about 1990.⁶⁰ An exact date is hard to identify

53. *Id.*

54. Frank Shafroth, *The State of E-Taxing and the Tax Gap*, 43 STATE TAX NOTES 903 (2007) (citing Janet Novack, *Tax Tattlers*, FORBES.COM, Feb. 28, 2007, http://www.forbes.com/2007/02/27/beltway-taxes-coalition-biz-washington-cz_jn_0228beltway_print.html); see also Press Release, Internal Revenue Serv., IRS Updates Tax Gap Estimates (Feb. 14, 2006), <http://www.irs.gov/newsroom/article/0,,id=154496,00.html>.

55. See *The Tax Gap and Tax Shelters: Before H. Comm. on the Budget*, 110th Cong. 1, n.2 (Feb. 2007)(written statement of Nina E. Olson, Nat’l Taxpayer Advocate), http://www.irs.gov/pub/irs-utl/nta_housebudget_testimony_021607.pdf (stating that the IRS is still using the 2001 figures).

56. See *A Closer Look at the Size and Sources of the Tax Gap: Hearing Before the U.S. Senate Committee on Taxation and IRS Oversight*, 109th Cong. 4 (2006) (statement of J. Russell George, Treasury Inspector Gen. for Tax Admin.), available at http://www.treasury.gov/tigta/congress/congress_07262006.pdf.

57. See, e.g., GOV’T ACCOUNTABILITY OFFICE, TAX GAP: A STRATEGY FOR REDUCING THE GAP SHOULD INCLUDE OPTIONS FOR ADDRESSING SOLE PROPRIETOR NONCOMPLIANCE, GAO-07-1014 (2007) [hereinafter TAX GAP] (discussing ways to decrease the tax gap through increasing the compliance of sole proprietors); *The Adequacy of IRS’s Res.: Hearing Before the Subcomm. on Commerce, Consumer and Monetary Affairs of the H. Comm. On Gov’t Operations*, 97th Cong. 1-2 (1982) (statement of William J. Anderson, Director, Gen. Gov’t Div.) (discussing the need for additional resources to fix the tax gap).

58. See *The Adequacy of the IRS’s Res.*, *supra* note 57, at 1.

59. See *id.* at attachment IV.

60. See *Tax Compliance: Reducing the Tax Gap Can Contribute to Fiscal Sustainability But Will Require a Variety of Strategies: Hearing Before the Comm. on Fin.*,

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because of the sheer magnitude of GAO reports that would need to be reviewed. As the GAO said in a 2005 report, “[w]e have long been concerned about tax noncompliance and IRS efforts to address it. Since 1990, we have had various aspects of tax noncompliance on our high-risk list . . .”⁶¹

One example of GAO persistence with no apparent results is in the area of independent contractors who fail to report their income. As far back as 1989, the GAO noted that misclassification of employees as independent contractors in 1984 resulted in lost tax revenue of over \$1.6 billion.⁶²

In 1992, the GAO again called for action. It noted that “IRS data . . . show that independent contractors report[ed] 97% of the income that appear[ed] on information returns, while contractors that do not receive these returns report only 83% of income.”⁶³ This is a decline of 14%. Other IRS and GAO studies show that information returns dramatically improve voluntary compliance.⁶⁴ Another solution mentioned was withholding.⁶⁵

It appears that these reports simply get dusty, if that is possible for PDF files. If Congress works quickly it can break the 30 year mark for fixing the problem it created in 1978 with the passage of § 530.⁶⁶ The problem also persists because of the failure of businesses to issue Form 1099 and the IRS failing to enforce greater compliance.⁶⁷ In 2007, House tax-writers “almost unanimously agreed that something must be done to . . . make some sense of the rules.”⁶⁸

Maybe a new report will shake up the IRS. In July, 2007, the GAO reported on the extremely large tax gap created by small business. The summary of that report, entitled “Tax Gap: A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance,” states that the IRS estimates that \$68 billion of the annual \$345 billion gross tax gap

109th Cong. 2 (2005) [hereinafter *Tax Compliance*] (statement of David M. Welker, Comptroller Gen. of the United States), available at www.gao.gov/cgi-bin/getrpt?GAO-05-527T.

61. *Id.*

62. Dustin Stamper, *Panelists Urge Rewrite of Worker Classification Rules*, 115 TAX NOTES 604, 604 (2007); see also *Tax Administration: Issues in Classifying Workers as Employees or Independent Contractor: Hearing Before the Subcomm. on Oversight Comm. on Ways and Means*, 104th Cong. 5 (1996) [hereinafter *Tax Administration*] (statement of Natwar M. Gandhi, Assoc. Dir. Tax Policy & Admin. Issues, Gen. Gov. Div.).

63. *Tax Compliance*, *supra* note 60, at 18.

64. See *id.* at 18-19.

65. *Id.*

66. See Stamper, *supra* note 62, at 604.

67. See *id.*

68. *Id.*

for 2001 was due to sole proprietors underreporting their net income by 57%.⁶⁹ A key reason for this underreporting is well known.⁷⁰ Unlike wage and some investment income, “sole proprietors are not subject to tax withholding, and only a portion of their net business income is reported to the IRS by third parties.”⁷¹

The small business report pointed out that the lack of IRS funding resulted in less than half the 2 million cases of known differences between Form 1099s and reported income being examined.⁷² In sample cases there was a 74% chance that the income was under reported.⁷³ The report also suggested that family income was being shifted to lower tax rate members.⁷⁴ “IRS data showed that 3% of all Form 1099-MISC returns had the same address for the business taxpayer and the payee — one indicator that a related-party transaction might exist.”⁷⁵ But, apparently little if anything is done to follow up on this issue.⁷⁶ The point is that the IRS lacks the resources to look into this issue.⁷⁷

The appendix to the July 2007 report listed several tax gap studies by the GAO.⁷⁸ They are informative in the nature of their examination and the apparent lack of follow-up by the IRS. The list is as follows:

- Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap. GAO-07-488T. Washington, D.C.: February 16, 2007.
- Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap. GAO-07-391T. Washington, D.C.: January 23, 2007.
- Tax Compliance: Opportunities Exist to Reduce the Tax Gap Using a Variety of Approaches. GAO-06-1000T. Washington, D.C.: July 26, 2006.

69. TAX GAP, *supra* note 57, at 1. *See also* Susan Cleary Morse, Using Salience and Influence to Narrow the Tax Gap 39 LOY. U. CHI. L.J. __ (2009) (opening sentence “Most small business and self-employed taxpayers cheat on their taxes.”).

70. *Id.*

71. *Id.*

72. *Id.* at 19.

73. *Id.* at 19 n.19.

74. *See id.* at 19.

75. *See Tax Gap, supra* note 57, at 19.

76. *See id.*

77. *Id.*

78. *Id.* at 68-69.

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- Tax Gap: Making Significant Progress in Improving Tax Compliance Rests on Enhancing Current IRS Techniques and Adopting New Legislative Actions. GAO-06-453T. Washington, D.C.: February 15, 2006.
- Tax Gap: Multiple Strategies, Better Compliance Data, and Long-Term Goals Are Needed to Improve Taxpayer Compliance. GAO-06-208T. Washington, D.C.: October 26, 2005.
- Tax Compliance: Better Compliance Data and Long-term Goals Would Support a More Strategic IRS Approach to Reducing the Tax Gap. GAO-05-753. Washington, D.C.: July 18, 2005.
- Tax Compliance: Reducing the Tax Gap Can Contribute to Fiscal Sustainability but Will Require a Variety of Strategies. GAO-05-527T. Washington, D.C.: April 14, 2005.
- IRS Audits: Weaknesses in Selecting and Conducting Correspondence Audits. GAO/GGD-99-48. Washington, D.C.: March 31, 1999.
- Tax Administration: Billions in Self-Employment Tax Are Owed. GAO/GGD-99-18. Washington, D.C.: February 18, 1999.
- Tax Administration: Issues Involving Worker Classification. GAO/T-GGD-95-224. Washington, D.C.: August 2, 1995.
- Tax Administration: Estimates of the Tax Gap for Service Providers. GAO/GGD-95-59. Washington, D.C.: December 28, 1994.
- Tax Administration: IRS Can Better Pursue Noncompliant Sole Proprietors. GAO/GGD-94-175. Washington, D.C.: August 2 1994.
- Tax Gap: Many Actions Taken, But a Cohesive Compliance Strategy Needed. GAO/GGD-94-123. Washington, D.C.: May 11, 1994.

- Tax Administration: Approaches for Improving Independent Contractor Compliance. GOA/GGD-92-108. Washington, D.C.: July 23, 1992.⁷⁹

VII. NATIONAL TAXPAYER ADVOCATE REPORTS

If reports could close the tax gap, then the GAO should have been a great start. Another excellent source of tax gap reports that contains extensive history and analysis is provided by the annual statements to Congress by Nina E. Olson, the IRS National Taxpayer Advocate. Just the titles to her statements and reports are illuminating. The titles alone illustrate the scope of these reports:

- The Causes of and Solutions to the Federal Tax Gap⁸⁰
- The Effects of Tax Compliance Initiatives on Small Business⁸¹
- The Tax Gap⁸²
- Before the Subcommittee on Federal Financial Management, Government Information, and International Security. Subject: The Tax Gap⁸³

79. *Id.* In addition, the GAO subsequently published a forum on tax compliance issues titled, *Another history lesson*. June, 2008, Highlights of the Joint Forum on Tax Compliance: Options for Improvement and Their Budgetary Potential. GAO-08-703SP, available at www.gao.gov/new.items/d08703sp.pdf

80. *Concurrent Resolution on the Budget Fiscal Year 2007: Hearing before the S. Comm. on Budget*, 109th Cong. 243-63 (2006) (statement of Nina E. Olson, National Taxpayer Advocate), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_senate_hearings&docid=f:26726.pdf.

81. *IRS Latest Enforcement: Is the Bulls-Eye on Small Business?: Hearing Before the H. Comm. On Small Business*, 109th Cong. 84-98 (2006) (statement of Nina E. Olson, National Taxpayer Advocate), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_house_hearings&docid=f:28570.pdf.

82. *Deconstructing the Tax Code: Uncollected Taxes and Issues of Transparency: Hearing Before the S. Comm. on Homeland Security and Governmental Affairs*, 109th Cong. 90-125 (2006) (statement of Nina E. Olson, National Taxpayer Advocate), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_senate_hearings&docid=f:30601.pdf.

83. *Uncollected Taxes: Can We Reduce the \$300 Billion Tax Gap?: Hearing Before the S. Comm. on Homeland Security and Governmental Affairs*, 109th Cong. 110-40 (2005) (statement of Nina E. Olson, National Taxpayer Advocate), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_senate_hearings&docid=f:24444.pdf.

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- Complexity, Compliance, and Communication, Why Should Taxpayers Comply in a Complex and Changing Tax Environment? Presentation to the President's Advisory Panel on Federal Tax Reform⁸⁴
- The Tax Gap and Tax Shelters⁸⁵

VIII. THE ABA IN 1988 AND OTHER STUDIES

It is not as if all of these reports were shocking news to anyone. As far back as 1988 the American Bar Association ("ABA") took on the tax gap.⁸⁶ The commission began its study in 1983.⁸⁷

This report is being published at a time of great concern, but also at a time of great possibilities for change with respect to tax cheating in particular and noncompliance in general. The concern arises from the impact of the tax gap on the budget deficit and from many indications that tax cheating is widely accepted. The possibilities arise from the passage of the Tax Reform Act of 1986 which, by eliminating or severely limiting many tax preferences and reducing individual income tax rates, should encourage a perception that the tax system has become fairer. At the same time, the Tax Reform Act introduces many new rules, creating possibilities for honest errors by taxpayers. This time of change can be used to improve the moral climate for tax compliance and to establish a more open and cooperative relationship between taxpayers and the Internal Revenue Service.⁸⁸

84. Nina E. Olson, National Taxpayer Advocate, Complexity, Compliance, and Communication, Why Should Taxpayers Comply in a Complex and Changing Tax Environment? Presentation to the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005), <http://www.irs.gov/pub/irs-utl/ntacomplexity030105final3wnotes.pdf>.

85. *The Tax Gap and Tax Shelter: Hearing Before the S. Comm. on Finance*, 109th Cong. (2004) (statement of Nina E. Olson, National Taxpayer Advocate), available at http://www.irs.gov/pub/irs-utl/nta_sfc_testimony_tax_gap062104.pdf.

86. American Bar Association Commission On Taxpayer Compliance, *Report And Recommendations On Taxpayer Compliance*, 41 TAX LAW. 329 (Winter 1987).

87. *Id.* at 329.

88. *Id.* at 330 (citations omitted).

Does this statement from the Executive Summary apply as much today as the authors thought it did in 1988?

The government and the ABA were not alone in addressing the problem. A 1990 study by various academics looked at three areas of IRS process: audits, information reporting, and criminal enforcement.⁸⁹ It stated that there was a “major shift in tax enforcement policy” with a “greater reliance . . . on information reporting,” and “fewer people have been audited or criminally prosecuted for tax violations . . .”⁹⁰

As part of the build up to the 1990 study, the ABA held a meeting in 1983.⁹¹ At that meeting, experts tried to reconcile the existing tax gap estimates and make some sense of the problem.⁹² In that report, the author states in the introduction that the topic is so broad and the evidence so spotty that the report had to be confined to the question of noncompliance with federal individual and corporate income taxes, noting that payroll taxes were also a very large component of the problem.⁹³

There is a very interesting article on the issue of tax amnesty. This article points out that there have been numerous attempts by Congress to enact some short term amnesty and that several states have actually adopted amnesty programs.⁹⁴ It also points out that amnesty as a concept is not new to the IRS:⁹⁵

In 1919, the Bureau of Internal Revenue adopted a policy of accepting offers in compromise of criminal liability in cases of voluntary disclosure. Approximately three weeks after its institution, however, the policy was amended to provide that offers in compromise of criminal liability would be considered, rather than automatically accepted, in voluntary disclosure cases.⁹⁶

89. Jeffrey A. Dubin, Michael A. Graetz & Louis L. Wilde, *The Changing Face of Tax Enforcement, 1978-1988*, 43 TAX LAWYER 893, 893 (Summer 1990).

90. *Id.*

91. See Graduate Tax Faculty of the N.Y.U. School of Law, *Selected Tax Reading*, 39 N.Y.U. TAX L. REV. 223 (1984) (reviewing James S. Henry, *Noncompliance with U.S. Tax Law—Evidence on Size, Growth and Composition*, 37 TAX LAW 1 (1983)).

92. See James S. Henry, *Noncompliance with U.S. Tax Law—Evidence on Size, Growth, and Composition*, 37 TAX LAW. 1 (1983).

93. *Id.* at 1-2.

94. See Bonnie G. Ross, *Federal Tax Amnesty: Reflecting on the States' Experiences*, 40 TAX LAW. 145, 149, 151(1986).

95. See generally *id.* at 145, 160, 161, 162, 168, 182 (explaining how federal tax amnesty has been previously discussed and how the IRS has participated in enhanced enforcement programs accompanying states' amnesty programs).

96. *Id.* at 146-47.

What about criminal prosecutions as a way to close the tax gap? That was the topic of a very interesting article that discusses how a case winds up as a criminal case, including a discussion of the federal sentencing guidelines for those convicted.⁹⁷ In a fuller discussion later, the article quantifies the number of cases, stating: “[f]or the first quarter of 2000, the Criminal Investigation Division . . . estimated that 651 tax offenders have been sentenced since October 1, 1999, through December 30, 1999, of which 533 cases resulted in prison terms.”⁹⁸ Does the quantity of cases seem underwhelming?

IX. THE IRS – TAXPAYERS JUST NEED TO UNDERSTAND THE CODE

Maybe the IRS just does not get it. In a recent publication meant for the construction industry, the IRS said “[t]his fact sheet is the 15th in a series to help reduce the tax gap by helping taxpayers better understand the tax code.”⁹⁹ Admittedly, the tax code is complicated. But does anyone believe that the complexity of the Internal Revenue Code is the cause of the tax gap for contractors? The lead item in the IRS construction industry publication is “[c]ontractors, subcontractors, and workers must pay taxes on income received for all work, including side jobs and work that is paid for with cash.”¹⁰⁰ Even a contractor who has never read the Code, or even § 61, would be hard-pressed to say they did not know that they had to pay taxes on their earnings. In the case of the construction industry (and many small businesses), the real problem is the underground economy and the desire not to pay income or payroll taxes. Thus, the blame for the tax gap should only be placed on the inability of the IRS to identify and assess wayward taxpayers and employers.¹⁰¹ By blaming the complexity of the Code, it appears the IRS wishes to transfer the blame to the taxpayers (who are, of course, primarily to blame). Simply put, some people prefer not to report their income or the income of their employees because it reduces their cash flow. However, to imply that they do not know any better because of the complexity of the tax law is a stretch.

97. Liezl Walker, *The Deterrent Value of Imposing Prison Sentences for Tax Crimes*, 26 NEW ENG. J. ON CRIM. & CIV. CONFINEMENT 1, 7-9 (2000).

98. *Id.* at 6.

99. Internal Revenue Service, *The Construction Industry and the Tax Gap*, August 2007, <http://www.irs.gov/newsroom/article/0,,id=173614,00.html>.

100. *Id.*

101. See Matthew P. Harrington & Eric A. Lustig, *IRS Form 8300: The Attorney-Client Privilege and Tax Policy Become Casualties in the War against Money Laundering*, 24 HOFSTRA L. REV. 623, 629-30 (1996).

Maybe all it takes to catch contractors and others who are not paying all their taxes is to have a chief executive that stays with the IRS long enough to make closing the tax gap a priority. How long would that be? Maybe ten years? Unfortunately, it seems that the length of service for an IRS Commissioner rarely exceeds four years.¹⁰² By the time they get a handle on the problem, it is probably too late in their tenure to implement a tax gap solution. Here is the list of commissioners and their time in that position since 1960:¹⁰³

Dana Latham	11/5/1958 - 1/20/1961
Charles I. Fox (Acting)	1/21/1961 - 2/6/1961
Mortimer Caplin	2/7/1961 - 7/10/1964
Bernard M. Harding (Acting)	7/11/1964 - 1/24/1965
Sheldon Cohen	1/25/1965 - 1/20/1969
William H. Smith (Acting)	1/21/1969 - 3/31/1969
Randolph W. Thrower	4/1/1969 - 6/22/1971
Harold T. Swartz (Acting)	6/23/1971 - 8/5/1971
Johnnie M. Walters	8/6/1971 - 4/30/1973
Raymond F. Harless (Acting)	5/1/1973 - 5/25/1973
Donald C. Alexander	5/25/1973 - 2/26/1977
William E. Williams (Acting)	2/27/1977 - 5/4/1977
Jerome Kurtz	5/5/1977 - 10/31/1980
William E. Williams (Acting)	12/1/1980 - 3/13/1981
Roscoe L. Egger, Jr.	3/14/1981 - 4/30/1986
James I. Owens (Acting)	5/1/1986 - 8/3/1986
Lawrence B. Gibbs	8/4/1986 - 3/4/1989
Michael J. Murphy (Acting)	3/5/1989 - 7/4/1989
Fred T. Goldberg, Jr.	7/5/1989 - 2/2/1992
Shirley D. Peterson	2/3/1992 - 1/20/1993
Michael P. Dolan (Acting)	1/21/1993 - 5/26/1993
Margaret Milner Richardson	5/27/1993 - 5/31/1997
Michael P. Dolan (Acting)	6/1/1997 - 11/12/1997
Charles O. Rossotti	11/13/1997 - 11/6/2002
Bob Wenzel (Acting)	11/7/2002 - 4/30/2003
Mark W. Everson	5/1/2003 - 5/4/2007
Kevin M. Brown (Acting)	5/5/2007 - 9/9/2007
Linda E. Stiff (Acting)	9/10/2007 - 3/24/2008
Douglas H. Shulman	3/24/2008 - present

102. See Commissioner of Internal Revenue Douglas Schulman, <http://www.irs.gov/irs/article/0,,id=98192,00.html> (last visited Oct. 28, 2008); Previous IRS Commissioners (1955-2008), <http://www.irs.gov/irs/article/0,,id=184235,00.html> (last visited Oct. 28, 2008); Previous IRS Commissioners (1862-1955), <http://www.irs.gov/irs/article/0,,id=184237,00.html> (last visited Oct. 28, 2008).

103. *Id.*

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If the average commissioner had stayed longer, perhaps he or she might have implemented successful attacks on the tax gap. Many alternative approaches have been suggested, and most do not appear to have been adopted. Is it possible that the short term nature of the leadership position has anything to do with the failure to find a solution? The choices for change are many, and some are discussed below.

X. INFORMATION RETURNS

Many of the current suggestions for reducing the tax gap deal with better information reporting of income.¹⁰⁴ They point out that more than 99% of those who receive wages pay their taxes.¹⁰⁵ They then often compare that high rate to the 1992 IRS estimate that less than 70% of net income earned by unincorporated business is correctly reported.¹⁰⁶ These articles then call for better gross reporting by third parties of internet auction sales.¹⁰⁷

Those who believe that they will be the subject of an IRS matching program will probably report more of their income than they do when there is no information return.¹⁰⁸ However, the research is not as positive as the above statistics might imply. First, the number of information returns is staggering. During the 1965 fiscal year, the IRS received approximately 340 million information reporting documents.¹⁰⁹ In 1990 over one billion such

104. See Jay A. Soled, *Homage to Information Returns*, 27 VA. TAX REV. 371, 371-72 (2007).

105. IRS Information Release, IR 96-27, (1996), 1996 IRB LEXIS 161.

106. *Id.*

107. See, e.g., *The Tax Gap: Hearing Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate* (2006) (statement of Nina E. Olson, National Taxpayer Advocate), available at http://www.irs.gov/pub/irs-utl/nta_testimony_senate_hsgac_092606.pdf (last visited Oct. 1, 2008).

108. For example, in a study detailing the impact of information document matching on reporting noncompliance, while finding that IRS's computerized document matching program did not bring about a statistically measurable impact on compliance during the period from 1982 to 1991, Plumley still thinks the program was effective because "most taxpayers apparently assumed that the matching was already in place, judging from the earlier compliance statistics." Alan H. Plumley, *The Determinants of Individual Income Tax Compliance: Estimating The Impacts of Tax Policy, Enforcement, and IRS Responsiveness*, IRS Publication 1916 (Rev. 11-96), at 36, available at: <http://www.irs.gov/pub/irs-soi/pub1916b.pdf> (last visited Oct. 1, 2008).

109. James Andreoni, et al., *Tax Compliance*, 36 J. OF ECON. LITERATURE, No. 2, 818, 821 (June 1998), available at <http://www.jstor.org/stable/2565123?origin=JSTOR-pdf>, at 821 (last visited Oct. 1, 2008).

documents were received.¹¹⁰ In fact, it is estimated that three-fourths of all income is reported on an information return.¹¹¹

The problem with the argument that information returns will force voluntary compliance is that there is some evidence that it does not work. The misreporting of alimony and unemployment income which are reported to the IRS (just like wages) is on the order of 20% and 10% respectively, according to one article.¹¹² Because alimony and unemployment are reported to the IRS, perhaps the large under-reporting will exist even if Form 1099 reporting by payors is increased.

XI. REWARDS FOR INFORMATION

It may not be very well known, but the IRS seems ready, willing and able to get help from those who have information that can help close the tax gap. Form 3949 A allows IRS agents to refer issues for investigation and lists the following categories under alleged violations of income tax law: False Exemption, Unsubstantiated Income, Unreported Income, Failure to Withhold Tax, False Deductions, Kickback, Narcotics Income, Wagering/Gambling, Multiple Filing, False/Altered Documents, Public/Political Corruption, Earned Income Credit, Organized Crime, Failure to Pay Tax, Failure to File Return, and others.¹¹³

The system for reporting to the IRS also has a reward of up to 15%.¹¹⁴ Under this system, one can call the IRS to prepare Form 3949 A.¹¹⁵ Form 211 also needs to be filed.¹¹⁶ The history

110. *Id.*

111. *Id.*

112. Wojciech Kopczuk, *Tax Simplification and Tax Compliance: An Economic Perspective*, in BRIDGING THE TAX GAP, ADDRESSING THE CRISIS IN TAX ADMINISTRATION (Max B. Sawicky, ed.) Economic Policy Institute, 111-43 (2006), available at <http://www.columbia.edu/~wk2110/bin/epi.pdf>, at 12 (last visited Oct. 1, 2008).

113. IRS Form 3949 A (Rev. 2-2007), available at <http://www.irs.gov/pub/irs-pdf/f3949a.pdf> (last visited Oct. 1, 2008).

114. For a complete discussion on IRS rewards, see Internal Revenue Manual 25.2, Information and Informants' Rewards, available at <http://www.irs.gov/irm/part25/ch02s01.html> (last visited Oct. 1, 2008). The whistle blower provisions were rewritten in 2007. Since then, over 600 alleged cases involving over \$ 2 million were filed. The IRS apparently only proceeded on 80 "high-value cases." See Michael Joe, Jump in IRS Whistle-Blower Claims Raises Critics' Moral Concerns 120 Tax Notes 928, 2008 TNT 171-3 (Sept. 2, 2008). Under the new procedures, awards are at least 15 percent but not more than 30 percent if the informant's information substantially contributes to the tax collection.

115. *Id.*

116. It appears the current system uses Form 211 (ever heard of that one?) and that the maximum is 15% on rewards up to \$10 million. See IRS Form 211 (Rev. 12-2007),

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of the use of such information is not altogether positive. The tip usually comes from a former boy- or girl-friend, spouse or business associate; however, less than 10% of the information is actionable.¹¹⁷ The best information typically comes from bookkeepers and others with access to a business's accounting records.¹¹⁸

Apparently not many people seek the reward. Although there is a lag of many years between the time someone is reported and the time someone is paid by the IRS, the following amounts were paid by the IRS in recent years:

- Fiscal 2001 - \$ 3.3 million
- Fiscal 2002 - \$ 7.7 million
- Fiscal 2003 - \$ 4.1 million
- Fiscal 2004 - \$ 4.6 million
- Fiscal 2005 - \$ 7.6 million¹¹⁹

If the IRS were serious about using taxpayer assistance, why is the reward form not a part of the normal Form 1040 package? One solution could be to combine Form 3949 A with Form 211 and call it Form 1040 15%. At the very least, the system of reporting unreported income and collecting a reward should be a simple one page form.

XII. AUDITS

Identification is a problem, and then there has to be a time-consuming audit of a self-employed individual that may lack books and records or receipts for all that cash. One report suggests that IRS audits have a very strong impact on

available at www.irs.gov/pub/irs-pdf/f211.pdf (last visited Nov. 15, 2008). With a potential for up to \$1.5 million, how likely is it that compliance might increase if small business owners knew that any employee they fire might turn around and complete the form included with their Form 1040 package (or with their TurboTax program) since they probably have actual knowledge that the boss was pocketing all of the cash receipts? For more information on the current system, see *id.*; Policy Statement 4-27 (Formerly P-4-86), available at <http://www.irs.gov/foia/article/0,,id=132336,00.html> (last visited Oct. 1, 2008).

117. Fulcrum Inquiry, L.L.P., *IRS Raises Stakes on Tax Whistleblower Claims* (2007), http://www.fulcruminquiry.com/IRS_Informant.htm (last visited Oct. 1, 2008).

118. *Id.*

119. *Id.*

compliance reporting.¹²⁰ Thus, if the IRS wants to garner greater compliance, it seems logical they would divert more of their resources to additional audits.

While testifying before the IRS, the GAO presented a report estimating that if it were to get \$2.2 billion in funding, it could take enforcement actions against potential noncompliant taxpayers that it has already identified.¹²¹ The result would be \$30 billion in revenue.¹²² As noted above, for only \$230 million in additional funding, the IRS could raise nearly \$7 billion in revenue.¹²³ Thus, enforcement is much more expensive than simple matching.

This is interesting when one considers that the fiscal year 2006 IRS budget request was only \$10.6 billion, or less than a \$500 million increase.¹²⁴ As more and more returns are filed electronically, shouldn't there be a year-to-year reduction in processing, thus freeing up funds for investigations? In fact, it was only 4.3%. This did include an 8% increase in enforcement, which, if applied to all of the matching, could bring in \$7 billion. So where was it applied?

The following chart shows, in five year intervals, that the number of IRS agents today is almost the same as the number in 1981 while the number of tax returns is almost 50% greater.¹²⁵

120. Alan H. Plumley, *The Impact of the IRS on Voluntary Compliance: Preliminary Empirical Results*, Panel Discussion at 95th Annual Conference Nat'l Tax Ass'n, at 8 (Nov. 14-16, 2002). Additionally, "since the effect is significantly larger than the direct revenue effect of the audits, these results suggest that the allocation of audit resources (which is currently based almost solely on their direct revenue potential) ought to be modified to reflect this indirect effect on voluntary compliance." *Id.* at 10.

121. *Tax Compliance: Multiple Approaches are Needed to Reduce the Tax Gap: Hearing Before the S. Comm. on the Budget*, 110th Cong. (Feb. 16, 2007), at 16 (statement of Michael Brostek) (citing Comm'r Charles O. Rossotti, Report to the IRS Oversight Board: Assessment of IRS and the Tax System, October 2002).

122. *Id.* at 17.

123. *Id.*

124. In part, the proposal would have allocated nearly \$1.3 billion to processing, \$3.7 billion to examinations, \$1.9 billion to collections, and \$767 million to investigations (criminal). IRS, *Budget in Brief Fiscal Year 2006*, at 4-5 (Feb. 2005), available at http://www.irs.gov/pub/irs-utl/bib_irs.pdf (last visited Aug. 22, 2007).

125. Transactional Records Access Clearinghouse, Syracuse University, <http://trac.syr.edu/tracirs/trends/v12/irsStaff.html> and <http://trac.syr.edu/tracirs/trends/v12/numDisAudits.html> (last visited Aug. 22, 2007).

**Internal Revenue Service Staff
(employees at close of year)**

Fiscal Year	Revenue	Revenue	Criminal	Service	Returns Filed
	Officers	Agents	Investigators	Total	
1981	5,342	13,492	2,730	85,672	93,052,000
1986	7,359	14,507	2,752	102,206	99,529,000
1991	8,377	16,377	2,884	119,213	112,304,900
1996	7,510	15,199	3,352	102,082	116,059,700
2001	5,879	12,371	2,820	99,893	127,097,210
2006	5,961	13,407	2,799	90,115	132,275,830

If anything, tax returns are also much more complicated, and the ability of taxpayers to use partnerships, s-corporations, trusts and offshore entities has certainly grown in the last 25 years.¹²⁶ So, why hasn't the IRS grown?

XIII. CRIMINAL AND CIVIL PROSECUTIONS AS A DETERRENT

It seems that the low number of criminal cases (and many of those are really not tax cases, such as those against drug dealers) means that the fear of criminal prosecution is not being used as a deterrent.¹²⁷ In fact, only one press release could be found that addressed the deterrent effect. A DOJ press release in 2001 states in part:

We . . . have a duty to current and future generations to see to it that all citizens pay their fair share. Prosecution of violations of the internal revenue laws serve to deter others; and increases the public confidence of conscientious taxpayers that the Service prosecutes violators . . . (The sentence in) this case is the result of continuous compliance efforts initiated by the IRS-Criminal

126. See, e.g., Neil Brooks, Key Issues in Income Tax: Challenges of Tax Administration and Compliance, Asian Development Bank 2001 Tax Conference (Sept. 8, 2001); Edmund L. Andrews, *I.R.S. Curtails Many Audits in Tax Havens*, N.Y. TIMES, May 3, 2007, at C1.

127. Jonathan M. Barnett, *The Rational Underenforcement of Vice Laws*, 54 RUTGERS L. REV. 423, 468 (2002).

Investigation to foster voluntary compliance with the nation's tax laws.¹²⁸

It is interesting that the IRS uses conferences rather than newspapers or general press releases to say that they are stepping up criminal cases. The IRS Criminal Investigation Director of Field Crimes, Field Operations, and Policy said that “[t]he more publicity we can get on our cases deters additional tax fraud and evasion.”¹²⁹ This statement was made to the National CPA/IRS Tax Issues Meeting in Washington in November, 2007.¹³⁰ The IRS said that 80% of cases that went to sentencing had some publicity, up from 68% four years ago.¹³¹

This high percentage of publicity would be impressive if there were hundreds of thousands of cases that were reported by local or national news services, many criminal cases, and if this acted as a deterrent. But, according to TRAC at Syracuse University, the number of criminal referrals (not cases that resulted in sentencing) in 2006 was only 2,469 or 841 per every 100 million persons.¹³² In 2005 it was 2,688, and the number convicted in 2006 was only 1,092,¹³³ a per capita rate of only 372 per 100 million. The conviction rate was only 1,086 in 2005.¹³⁴ So, how much publicity did the 80% represent?

The new head of CI is quoted as saying they are being aggressive and that 14% of their resources are for nonfilers. The 2006 – 2007 numbers are for all criminal cases and only 59% have a tax component.¹³⁵

128. Press Release, Dep't of Just. (March 30, 2001), *available at* <http://www.usdoj.gov/tax/usaopress/2001/txdv01033001bFrame1Source1.htm>. It is interesting to note that there do not appear to be any other similar press releases. Moreover, the press release says that the total tax liability was around \$5,000 for two years, which is not very large in tax areas, yet the sentence was 16 months.

129. Dustin Stamper, *IRS Criminal Investigation Division to Increase Publicity*, 2007 TAX NOTES TODAY 217-4, Nov. 28, 2007.

130. *Id.*

131. *Id.* It is interesting that in searching Google by the name of the IRS director who made the statement and the word “publicity,” the statement could not be found.

132. IRS Criminal Referrals—In Relation to District Population 2006, *available at* <http://trac.syr.edu/tracirs/findings/06/criminal/refA06.html> (last visited Aug. 22, 2007).

133. IRS Criminal Referrals — In Relation to District Population 2005, *available at* <http://trac.syr.edu/tracirs/findings/06/criminal/pguiA06.html> (last visited Aug. 22, 2007).

134. IRS Criminal Referrals—In Relation to District Population 2006, *available at* <http://trac.syr.edu/tracirs/findings/06/criminal/refA06.html> (last visited Aug. 22, 2007).

135. Jeremiah Coder, *IRS CI Division to Stay 'Aggressive' Under New Chief*, TAX NOTES, May 21, 2007, at 705.

Fiscal Year 2007¹³⁶	Totals
Investigations Initiated	2000
Prosecution Recommendations	1388
Information/Indictments	1117
Total Convictions	1087
Total Sentenced*	1081
Percent to Prison	82.2%
Average Months to Serve	41

With millions of taxpayers not voluntarily filing their tax returns or substantially under-reporting their incomes each year, can the above-noted isolated press release made over five years ago, with no follow up, be taken seriously, given the less than 2,500 criminal cases each year? Even if it were to be taken seriously, it is hard to believe the public will take it seriously if they have never heard of criminal tax evasion and if they do not know anyone who has ever been charged with criminal tax evasion.

Civil penalties are just as infrequently imposed. A 1983 article said that the 1969 TCMP survey suggested that auditors would find only five fraudulent returns and eight negligent returns out of every 10,000 received.¹³⁷ Such low rates, if known,

136. IRS Criminal Investigation, Current Year Fiscal Statistics. Statistics current as of August 22, 2007. Updated statistics available at <http://www.irs.gov/compliance/enforcement/article/0,,id=107485,00.html>.

	FY 2006	FY 2005	FY 2004
Investigations Initiated	3907	4269	3917
Prosecution Recommendations	2720	2859	3037
Information/Indictments	2319	2406	2489
Total Convictions	2019	2151	2008
Total Sentenced*	2020	2095	1777
Percent to Prison	82%	83%	84%

available at <http://www.irs.gov/compliance/enforcement/article/0,,id=107484,00.html>.

137. Charles T. Clotfelter, *Tax Evasion and Tax Rates: An Analysis of Individual Returns*, 65 REV. OF ECON. AND STAT. 363, 365 (1983). According to one article, the IRS stopped \$188 million in fraudulent refunds on 2006 tax returns. It is estimated that they failed to detect \$894 million in fraudulent refunds because their fraud detection system was not working. In 2007, the system was working and the IRS stopped \$1.2 billion in fraudulent refunds and missed \$742 million in fraudulent refunds. See IRS Issued \$1.6

certainly would not put fear in the hearts of taxpayers. Add that to the fact that a large number of taxpayers—30% in one survey— said they had never had their tax returns audited.¹³⁸ However, 60% of those surveyed rated the IRS as fairly or highly efficient.¹³⁹

Why so few criminal cases? One article states:

The IRS has never recommended criminal prosecution to the Department of Justice when taxpayers came forward and made a true voluntary disclosure of failing to file returns and filed accurate returns of their own volition. Nonfilers generally only need to be concerned about talking with the IRS about whether penalties can be waived for reasonable cause and making arrangement to pay the delinquent taxes, interest and any penalties which may apply.¹⁴⁰

The actual numbers when dealing only with those who are considered “nonfilers” is even more enlightening. The IRS has released the following data¹⁴¹ about criminal investigations that relates only to nonfiler enforcement:

	FY 2006	FY 2005	FY 2004
Investigations Initiated	562	549	417
Prosecution Recommendations	322	413	317
Indictments / Informations	307	316	277
Sentenced	270	280	194
Incarceration Rate¹⁴²	80.00%	78.20%	92.30%
Avg. Months to Serve	40	34	36

Billion in Fraudulent Tax Refunds, WEBCPA, <http://www.webcpa.com/article.cfm?articleid=29716> (last visited Oct. 31, 2008).

138. Young-dahl Song & Tinsley E. Yarbrough, *Tax Ethics and Taxpayer Attitudes: A Survey*, 38 PUB ADMIN. REV 442, 448 (1978).

139. *Id.* at 449.

140. UncleFed's Tax Board, IRS Plans to Bring Nonfilers Back Into the Tax System, Sept. 1, 1992, <http://www.unclefed.com/Tax-News/1992/Nrfs92-05.html>.

141. I.R.S. Criminal Investigation, Statistical Data – Nonfiler Enforcement, available at <http://www.irs.gov/compliance/enforcement/article/0,,id=106380,00.html> (last visited Aug. 22, 2007).

142. The incarceration rate includes confinement to a federal prison, halfway house, home detention, or some combination thereof.

XIV. IRS – FAILURE TO FOLLOW UP

The IRS stated in 1992 that they were going to go after nonfilers. It said that 2,000 agents had been reassigned to contact taxpayers who had not filed, and that they would even prepare returns for them.¹⁴³ In egregious cases, criminal sanctions were mentioned.¹⁴⁴ It would seem that if the 2,000 agents had worked just 200 days per year and sent out three letters an hour or 24 per day, in one year they would have contacted almost 10 million nonfilers, and the problem would have been solved in less than two years.

So was the problem solved? Were all, or mostly all, of the nonfilers identified and entered back into the system? Not if one looks at the post-1992 IRS statements that they do not have the resources to follow up on leads and that there remain a large number of nonfilers.

The IRS continues to assert that it cannot solve the tax gap problem due to lack of staff (resources). As listed above, the number of IRS employees has stayed fairly constant. But, as demonstrated by the IRS redeployment in 1992, people can be moved from one job to another.¹⁴⁵ Also, modernization, such as e-filing and the move from paper filing to required magnetic submission of Form 1099s, should have freed up valuable resources. Where were those dollars redirected?

Another problem is that not all e-filed forms that the IRS receives are easily turned into taxpayer information. From 1995 to 1998 the IRS received about 9.6 million information returns (Forms 1099-MISC), reporting approximately \$204 billion in non-employee compensation that either did not have taxpayer ID numbers or had one that did not match the IRS records.¹⁴⁶ The IRS apparently just keeps that statistic, and there is no follow-up.

Has this improved since 1998? How many of these problems could have been resolved quickly and inexpensively with a request for additional information? Why does the IRS not request filers of Form 1099-MISC to include an email address. If they had an email address, the IRS could request additional information at a very low cost to the IRS and to the payor.

143. IRS Plans to Bring Nonfilers Back Into the Tax System, *supra* note 140.

144. *Id.*

145. UNITED STATES GENERAL ACCOUNTING OFFICE, Report to Designated Congressional Committees, at 54-55, (1995), available at <http://www.gao.gov/archive/1995/gg95066.pdf> (discussing IRS redeployment).

146. TIGTA Says IRS Needs More Resources to Close Tax Gap, TAX NOTES TODAY, July 26, 2006, at 144-52.

The IRS's problems may relate to a lack of resources or its inability to use all of its collection power. A 1999 GAO report says:

IRS' accounts receivable data as of September 27, 1997, showed that more than 1.9 million self-employed taxpayers were delinquent in paying \$6.9 billion in self-employment taxes on 3.6 million returns. . . . Also, more than 144,000 taxpayers with delinquent self-employment taxes of \$487 million were receiving about \$105 million in monthly Social Security benefits.¹⁴⁷

What does this say about IRS collections? Should Congress give the IRS more authority to attach wages of those who do not pay ("nonpayors")?

The IRS also appears to have a problem collecting unreported taxes from taxpayers with offshore accounts. A 2002 article states that the IRS will start looking for taxpayers with offshore accounts who are not reporting income from those accounts.¹⁴⁸ At the time, using information from just three tax shelter countries, the IRS estimated that one to two million taxpayers were using offshore accounts; furthermore, failure to disclose the accounts is punishable by up to five years in jail.¹⁴⁹ Since only 117,000 taxpayers disclosed these accounts in 1999, it would appear that there are probably over 100,000 criminal cases possible for accounts in those three countries alone.¹⁵⁰

Regardless of the possibilities, seven years later, the *New York Times* reported that the IRS was curtailing audits of those who use offshore tax havens.¹⁵¹ Apparently, even if a tax agent finds evidence of tax evasion, the IRS cannot meet the three-year deadline for finishing an examination.¹⁵² Yet, why not simply file criminal charges as long as the IRS can prove an evasion or a failure to disclose the offshore account?

The Treasury Department acknowledges these shortcomings. In 2004, Deputy Treasury Secretary Samuel W.

147. U.S. GEN. ACCOUNTING OFFICE, TAX ADMINISTRATION: BILLIONS IN SELF-EMPLOYMENT TAXES ARE OWED 3 (1999).

148. See Loretta Kald, *IRS Targeting Offshore Shelters, Income Schemes*, SACRAMENTO BEE, Sept. 15, 2002, at D3.

149. David Cay Johnston, *I.R.S. Says Offshore Tax Evasion Is Widespread*, N.Y. TIMES, March 26, 2002, at A1.

150. *Id.*

151. Edmund L. Andrews, *I.R.S. Curtails Many Audits In Tax Havens*, N.Y. TIMES, May 3, 2007, at C1.

152. *Id.*

Bodman acknowledged that 2.25 million cases, totaling more than \$16.5 billion in delinquent taxes have not been pursued by the IRS since 2002.¹⁵³ Based on that information, it was estimated that in just one year, the IRS would assess almost \$30 billion of taxes in a single year that it will never collect because of the scarcity of IRS staff resources.¹⁵⁴

Additionally, a 2004 report by TIGTA stated that the number of potential individual nonfiler cases identified by the IRS had increased from 6.1 million in 1994 to 8.9 million in 2001.¹⁵⁵ At the same time, it said that the resources applied to combat this trend had decreased.¹⁵⁶ It noted that only about 1.9 million of the 2.7 million taxpayers who were sent return delinquency notices in 2003 received further IRS compliance treatments if the nonfiling situation was unresolved.¹⁵⁷

In an ironic twist, the IRS is apparently aware of more than 450,000 federal employees who owe a combined balance of almost \$3 billion in back taxes.¹⁵⁸ For instance, 56,000 Post Office employees owe a combined \$320 million; only 22,000 of them have agreed to a payment plan to pay off their delinquent taxes.¹⁵⁹ Even at the Treasury Department, which has the best record for employees being current on their tax payments, their rate of delinquent taxpayers is “fewer than 2 percent.”¹⁶⁰

XV. FUNDING OF IRS ENFORCEMENT

In 1990, the IRS had a budget of \$5.2 billion.¹⁶¹ The IRS's \$6.8 billion budget request was reduced \$1.6 billion by the Reagan White House.¹⁶² The first Bush administration then

153. Jonathan Weisman, *IRS Opting Not to Go After Many Scofflaws*, WASH. POST, March 20, 2004, at A1, available at <http://www.washingtonpost.com/ac2/wp-dyn/A9435-2004Mar19?language=printer>.

154. *On Waste, Fraud, and Abuse In Federal Mandatory Programs, Before the H. Comm. on the Budget*, 108th Cong. 6 (2003) (statement of Leonard E. Burman, Senior Fellow, the Urban Institute).

155. Dep't of the Treas., *The Return Delinquency Notice Program Could Be Used More Effectively to Promote Filing Compliance and Reduce the Tax Gap* (2004), available at <http://www.treas.gov/tigta/auditreports/2004reports/200430127fr.pdf>.

156. *See id.*

157. *Id.*

158. Robert's US Government Info Blog, <http://usgovinfo.about.com/b/> (April 27, 2007).

159. Mark Segraves, *Federal Workers Owe Billions in Unpaid Taxes*, <http://www.wtop.com/?nid=428&sid=1034585> (last visited October 26, 2008).

160. *Id.*

161. William J. Eaton, *Hill Report Depicts IRS as a Hobbled Behemoth*, WASH. POST, Jan. 10, 1990, at A17.

162. *Id.*

refused to adjust the budget.¹⁶³ The IRS stated that \$60 billion in uncollected taxes could not be recovered due to their lack of resources.¹⁶⁴

In 1997, it appears that the IRS had a \$7.3 billion budget and employed more than 100,000 people.¹⁶⁵ If the IRS already knew about the nonfilers and those who under-reported their income, why could they not reassign 1% or just 1,000 employees to the task of getting them into the system?

The IRS proposed fiscal year 2007 budget request was nearly \$10.6 billion, plus supplements, for a total budget of just over \$11 billion.¹⁶⁶ This represents only a 1.4% increase from the 2006 enacted level.¹⁶⁷ In contrast, the IRS proposed budget for fiscal year 2008 is almost \$11.1 billion.¹⁶⁸ This represents more than a \$600 million increase, or 6.3%, over 2007.¹⁶⁹ Given the ever-increasing budget, it appears that the allocation to non-filers is not a high priority.

XVI. CONCLUSION

What is the bottom line? Only with voluntary compliance by the American taxpayer can we close the tax gap. The IRS needs to be properly funded, and the IRS needs to make it known that they are ready, willing and able to locate, audit and prosecute taxpayers who are not paying their taxes in full. This will never be 100% successful, but talking about the problem has had little effect.

Congress must be part of the solution. It must make legislative changes that were recognized by the IRS, commentators and the GAO over twenty years ago, and not simply allocate a larger budget to the IRS. It is time for the Congress to incorporate most of the ideas that give the IRS better information reports.

It is also time the IRS issue more than one press release that they are doing their job of catching and convicting tax cheats. It should be a daily event, challenging the American public to guess

163. *Id.*

164. *See id.*

165. Joseph Thorndike, *The IRS Is Hiding Its History*, WASH. TIMES, Dec. 19, 1997, at A23.

166. DEPT OF THE TREAS., BUDGET IN BRIEF FY 2007 60, available at <http://www.irs.gov/pub/irs-news/fy07budgetinbrief.pdf> (last visited Oct. 28, 2008).

167. *Id.* at 59.

168. DEPT OF THE TREAS., BUDGET IN BRIEF FY 2008 1, available at <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf> (last visited Oct. 28, 2008).

169. *Id.*

which neighbor has been caught. Until the punishment fits the crime, the crime will persist.

Congress and the IRS can never totally eliminate the tax gap. The tax gap is far too complex, and it involves far too many people. Regardless, both must do a better job of trying. Reports do not appear to be the answer and neither are more studies such as more TCMP audits. Maybe the foregoing suggestions do not go far enough, but they represent a place or places to start. Since the IRS has requested more money for 2008, perhaps it could implement some of the suggestions that already exist rather than write another report or perform another study.¹⁷⁰

170. *Id.* at 10. As hinted at in the FY2008 budget, the IRS is looking for help from Congress. This arguably represents a fair summary of the current IRS wish list:

- 1) require information reporting on payments to corporations;
- 2) require basis reporting on security sales;
- 3) expand broker information reporting;
- 4) require information reporting on merchant payment card reimbursements;
- 5) require a certified taxpayer identification number (TIN) from non-employee service providers;
- 6) require increased information reporting for certain government payments for property and services;
- 7) increase information return penalties;
- 8) require electronic filing by certain large businesses;
- 9) implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes;
- 10) amend collection due process procedures applicable to employment tax liabilities.
- 11) expand IRS access to information in the National Directory of New Hires database;
- 12) permit the IRS to disclose to prison officials return information about tax violations;
- 13) make repeated failure to file a tax return a felony.
- 14) expand preparer penalties;
- 15) impose a penalty on failure to comply with electronic filing requirements;
- and
- 16) create an erroneous refund claim penalty.