Tax Administration: Compliance, Complexity, and Capacity

APRIL 8, 2019

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• Some shared goals for the tax system:
  – Easy to understand
  – Easy to comply with
  – Efficient
  – Equitable

• Compliance costs/complexity

• Enforcement issues/IRS capacity
TAX COMPLEXITY AND THE COST OF COMPLIANCE

• Aggregate costs of compliance probably exceed $200 billion per year

• Costs depend on
  – Level and types of income
  – Types of deductions and credits

• Tax code complexity is a political choice
SHARE OF COMPLIANCE BURDEN BY SOURCE

Source: Marcuss et al. (2013)
COMPLIANCE CHALLENGES AND THE TAX GAP

• Tax gap: taxes that are owed but are not paid in a timely or voluntary manner
  – Net tax gap averaged $406 billion per year from 2008-2010 (~2.8 percent of GDP)

• Harmful in two senses:
  – Reduces necessary revenue
  – Unfairly burdens those who do pay their taxes

• Evasion depends on administrative features
  – Withholding (and reporting)
  – Reporting
  – Neither

Added
INCOME TAX GAP AND MISREPORTING BY MAJOR INCOME TYPE

Note: Columns do not add up to 100 percent. The NMP for capital gains is 21 percent, as indicated via correspondence with IRS analysts, not 27 percent as reported in Internal Revenue Service (2016).
EVASION AND INCOME BY INCOME GROUP, 2001

Source: Johns and Slemrod (2010)

Note: Income groups are classified using estimated true AGI.

- Share of Tax Underreporting
- Share of AGI
• Successful anti-poverty programs

• Administration through the tax code has some benefits
  – Low administrative costs (less than 1% of benefits provided)
  – Take-up (80%) higher than many non-tax programs (SSI at 60%, TANF at 26%)

• EITC improper payments rate reported at 22-26%, but likely lower
  – At most, this is 6% of the gross tax gap
EITC AND CTC: ADMINISTRATIVE ISSUES

• Still, room for improvement
  – Improper payments can erode support for the program
  – Errors cause loss or delay in benefits

• Over- and underclaims are due to a number of reasons:
  – Complex eligibility requirements
  – Resource constraints at the IRS
  – Fringe tax preparers
IRS COST OF COLLECTING $100 OF REVENUE, 2008-2017

Source: Internal Revenue Service (2018)
• Exact withholding versus Taxpayer Agency Reconciliation (TAR)

• Successful TAR experiment in California

• Creating a widely applicable TAR program at the federal level would require significant structural changes to the tax system (as well as increased IRS funding)
CONCLUSION

• Complexity and compliance costs are
  – The result of trade-offs in the tax system
  – Policy choices

• Complexity and IRS capacity drive all of the issues described here