Tax Tips You Can Use October 2007

"Tax Gap" Part 1

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Each year the IRS commissioner reports to Congress on the tax system and one area that she or he discusses is the "Tax Gap". The next two articles will discuss aspects of the tax gap.

The tax gap is the tax money that was actually paid compared to the amount that should have been paid to the federal government. Sometimes this number includes only the amount paid on time and sometimes it includes the amounts paid on time, paid late, and paid after collection efforts. The tax gap has three components: Non-filers or taxpayers who don't file a tax return for some period; people who file but do not pay the full amount of tax owed; and taxpayers who under-report their income or over-report their expenses. The IRS did a study in 2001 by auditing a number of people and determined that the tax gap was about $345 Billion dollars for that year. The IRS estimates that even after collection efforts, they collect only 86% of what should be paid in taxes.

The tax gap affects us all because our tax rate (or deficit) could be 14% lower if 100% of people paid the taxes that were due, and also the IRS has stepped up its efforts to collect more of the taxes due causing more paperwork for everyone. As most people know, each year taxpayers receive more tax information statements from banks, mortgage companies, brokerage firms and other companies.

Non-filers are estimated to cause about 10% of the tax gap. These are people who chose not to or are prevented from filing a tax return at all. The IRS knows about a lot of these people because banks report interest to their social security number or brokerage firms report stock dividends or sales or companies report wages. The IRS has stepped up its efforts to prepare its own tax returns for these people. If the taxpayer is getting a refund, the computer just moves on. The reality is that if the taxpayer wants to make a donation to the treasury and leave their tax year open for audit, so be it. However if the computer thinks that the taxpayer owes money after its conservative calculation then it sends a tax bill. Unless the taxpayer responds with other information or an actual tax return, the bill becomes final and collectible.

The second part of the tax gap, about 5%, are taxpayers who file their tax returns, but don't pay the full amount due on the return. I have seen taxpayers who have stacked up tax debts for years before the IRS descends upon them. One of my instructors wondered aloud why anyone would think that the biggest, most powerful debt collector in the history of the world would pass them by, but people do think that the IRS will not come looking for them. If a taxpayer is known to owe money, they are the easiest target to help lower the tax gap. In recent years, the IRS has added many agents to go after these known tax debts, including additional personnel in the Medford office.

The biggest portion of the tax gap is made up of taxpayers who do not report all of their income or report more than their legitimate expenses. This category makes up almost 85% of the tax gap. Next month I will write about the IRS efforts to find these individuals and businesses.

The fine print is that this article is for information only. Please call Kathy or a tax professional for questions about your individual tax situation. The Jacksonville Tax Lady can be reached at 541-899-7926 or at 610 North Fifth Street.