



## NEWS FROM EPI

EMBARGOED UNTIL

Thursday AM  
April 6, 2006

## CONTACT

Nancy Coleman  
Karen Conner  
Stephaan Harris  
202-775-8810  
[news@epi.org](mailto:news@epi.org)

## TAX ENFORCEMENT CRISIS GROWS

### New book details extent, causes and cures for tax cheating

Most Americans spent part of the past two months hunched over their computer keyboards or tax forms, toiling to get their income taxes filed on time. But many did not. In fact, nonpayment and underpayment of taxes have reached the crisis stage, one that in 2001 deprived the federal government of an estimated \$353 billion in revenues and has most likely worsened since then. That loss – about \$16 out of every \$100 owed – drives budget deficits deeper and penalizes the law-abiding with fewer services and/or higher tax rates than would otherwise be needed.

A new book published today by the Economic Policy Institute, *Bridging the Tax Gap*, gives taxpayers and lawmakers a detailed diagnosis of the problem and offers a number of prescriptions for treating it. Edited by EPI economist Max B. Sawicky, the book combines the expertise of leading tax experts, including two former IRS commissioners, to cast new light on the murky and widening world of tax evasion and avoidance. ([Click here for the table of contents and contributors' bios.](#))

“So many people have found ways to dodge their tax obligations with such impunity that the honor system that underpins IRS tax enforcement is unraveling,” said Sawicky. “The problem is worst among the highest earners who, aided and abetted by a whole cottage industry of consultants, have become grand masters at the tax-ducking game and who, even if caught, usually pay only cents on the dollar in settlements.”

#### How big a problem?

- According to the latest IRS data, the total gap between all taxes owed and taxes paid grew about 11% - from 14.9% to 16.6% between 1988 and 2001; during that same period, the gap between just what *individuals* owed and paid grew as much as 25%.
- Most of the \$353 billion gap (\$250-\$292 billion) is the result of underreported income, with \$32 billion more from under-payers and \$30 billion from non-filers.
- From \$150-\$187 billion of the gap comes from underreporting by individuals and small businesses (everything from street vendors to law firms).
- Underreporting by small businesses is estimated to be about 50%.
- According to Robert S. McIntyre, who explores tax shelters in his chapter, most big corporations have tax-haven subsidiaries to hide profits from tax. He cites, for example, Wachovia Bank, which successfully avoided all federal income taxes in 2002 by “owning” a German town’s sewer system.
- Tax avoidance is a huge problem for states as well, as corporations shift their headquarters to non-income tax states; this practice among just 252 of the most profitable corporations, according to McIntyre, cost state governments around \$42 billion from 2001 to 2003.

-More-

## **Tax-dodging á la modem**

Take offshore tax havens, where investment and income information is protected from disclosure to any taxing agency, and add the internet, and the result is more and more corporations and investors operating out of sight or reach of any tax authority. In their chapter exploring the global issues, Joseph Guttentag and Reuven Avi-Yonah write:

“Simply put, we have the technology that enables people to conduct their affairs without regard to national borders and without transparency, while restricting tax collectors to geographic borders that are meaningless in today’s world.” The losses to the United States are enormous. For example:

- U.S. residents hold an estimated \$1.5 trillion in offshore investments. Assuming annual income from those investments at 10%, those investments add up to about \$50 billion of unpaid taxes per year.
- In 2001, entities in the Grand Caymans held \$800 billion in U.S. deposits, a sum estimated to be increasing by \$120 billion per year. Over and above any national security concerns raised by this free, easy, and invisible flow of capital, the losses to the United States in unpaid taxes for 2002 alone have been estimated at \$70 billion.

## **What can we do to close the tax gap?**

The conventional image of a phalanx of stern IRS auditors bearing down on deadbeat taxpayers has become more the stuff of fiction than reality. As enforcement budgets have been slashed, the odds of getting away with tax evasion have risen, weakening the incentive for voluntary compliance. In an interview published as Chapter 2 of the book, former IRS Commissioner Sheldon S. Cohen puts it bluntly: “We have no tax enforcement, basically.”

With the percentage of returns that get audited now at only about 0.6%, the contributors to *Bridging the Tax Gap* place greater enforcement high on their list of remedies, especially since the dollars spent on enforcement yield far larger sums for the treasury. Among other proposals by one or more of the authors are:

- Adding enforcement capacity to the IRS, especially targeting enforcement areas that are now understaffed. (See Sawicky’s [analysis](#) of enforcement focus on EITC claims.)
- Building international cooperation, through the Organization for Economic Cooperation and Development (OECD), to create incentives and sanctions for tax haven nations to report investments and income.
- Simplifying the tax code to help cut down inadvertent mistakes and to reduce the possibility for loopholes.
- Increase direct reporting to the IRS of income and tax-related information – such as reports from charities of donations and from investment funds of dividend income.
- Require letters approving tax shelters to be filed with the IRS.

“For the wealthy and their tax advisers, we have entered the era of the do-it-yourself tax cut,” said Sawicky. “Meanwhile, middle- and low-income earners are bearing a larger share of the brunt of enforcement actions while the true robber barons of the tax world are getting off essentially scot-free.”

# # #

*The Economic Policy Institute is an independent, nonprofit, nonpartisan research institute – or “think tank” – that researches the impact of economic trends and policies on working people in the United States and around the world.*