2013 Budget Note

The Department of Revenue shall submit a report to the Legislature during the 2014 session that describes the cause of noncompliance in the personal and corporation tax programs, including a discussion of tax gap estimates. The Department shall create a specific, systemic plan to reduce the tax gap including performance measures, benchmarks, and timelines, and report progress from this plan to the Legislature in 2015. Where possible, the Department shall incorporate the results of the work performed for the Enforcement Revenue Budget Note in 2011.
Tax Compliance

• Three components:
  • Filing a tax return on time.
  • Accurately reporting.
    • Income
    • Deductions
    • Credits
    • Other—age, dependents, filing status, residence...
  • Full and timely payment.

• Not always a bright line defining compliance.
Motive for Noncompliance

- **Motive**
  - Economic model—Taxpayer knowingly noncompliant and is basing decision solely on “compliance gamble”.
  - Taxpayer morale (examples of other factors):
    - Social
    - Political
    - Effort required to comply exceeds motivation.
  - Often noncompliance is inadvertent.
Opportunity for Noncompliance

- Income visibility
  - Compliance is much higher where third-parties provide corroboration for taxpayer reported amounts.
  - Compliance is even higher when tax is withheld at source.

- Complexity
  - Increases level of difficulty involved in compliance.
  - Provides cover for intentional understatement.
Tax Gap

• Can’t be measured.
  • Only taxpayer can know true liability.
    • Some don’t know true liability.
    • Some hide true liability.

• If it could be directly measured it would be much smaller—Gap is inherent in voluntary reporting, and nature of income tax. Smaller for other tax types (e.g. VAT, Sales Tax, Property Tax) and larger for others (e.g. Use Tax).

• Estimates are extremely rough.
  • But relative contribution to tax gap from different items is a good guide (e.g. small business income contributes much more to personal income tax gap than wages).
How is Tax Gap Estimated?

• Several ways to estimate.
  • Survey data (Census).
  • State-level estimates of income types (BEA).

• Oregon DOR uses IRS estimates.
  • Net compliance by return components for personal income tax (from audit research sample).
  • High-level compliance estimate for corporations (from operational audits).
Tax Gap is Mostly Not Collectible

- Example: low visibility income.
  - IRS method of estimation is to intensively audit sample of taxpayers.
  - When they find understatement, they estimate the gap is higher than what was found (e.g. a factor of 4 might be applied).

- Mathematically, only about one-fourth of largest gap contributions (i.e. small business income) could be found, and might be paid...but only if every taxpayer were audited.
Tax Gap Estimate Comparisons

Generally not meaningful.

- Comparison over time—More likely to reflect change in income sources or estimation method than change in compliance program effectiveness.
- Comparison across states—More likely to reflect differing income sources, tax bases or estimation method than differing compliance program effectiveness.
Example Of Comparing Gap Estimates Across States

- Assume income misstatement is 10%.
- One tax return true taxable income = $37,000.
  - Reported income is $33,300.
- State 1: 4% rate on income above $15,000.
- State 2: 6% rate on income above $20,000.

<table>
<thead>
<tr>
<th></th>
<th>Tax Return</th>
<th>Estimated True Amounts</th>
<th>Tax Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Income</td>
<td>Tax</td>
<td>Income</td>
</tr>
<tr>
<td>State 1</td>
<td>$33,300</td>
<td>$732</td>
<td>$37,000</td>
</tr>
<tr>
<td>State 2</td>
<td>$33,300</td>
<td>$798</td>
<td>$37,000</td>
</tr>
</tbody>
</table>
Tax Gap Estimates

• Applying Federal Estimates to Oregon.
  • Personal income tax.
    • Net Gap = $1,137 million (17.8%).
    • $1,536 - $148 - $250
      (Gross - Late/Enforced - Unclaimed Withholding)
  • Corporate Excise/Income Tax (Tax Year 2010).
    • Net Gap = $70 million (14.1%).
    • $98.9 million - $28.9 million
      (Gross - Late/Enforced)

• Value of estimating tax gap—Primarily in understanding relative noncompliance of types of income, deductions, credits etc.
Questions?
### Personal Income Tax Accounts Receivable

**Approximate Balances and Summary of Change: Fiscal Year 2013**

**Liability Basis**

<table>
<thead>
<tr>
<th>FY End 2012</th>
<th>Self Assessed</th>
<th>Deficiencies</th>
<th>Enforced Filing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Liabilities</td>
<td>234,665</td>
<td>64,995</td>
<td>64,570</td>
<td>364,250</td>
</tr>
<tr>
<td>Balance 6/30/2012</td>
<td>$270,140,000</td>
<td>$86,220,000</td>
<td>$264,440,000</td>
<td>$620,800,000</td>
</tr>
</tbody>
</table>

**Summary of All Liabilities in A/R System during Fiscal Year**

| Number of Liabilities | 368,275 | 96,800 | 93,640 | 558,715 |
| Balance 6/30/2012 | $270,140,000 | $86,220,000 | $264,440,000 | $620,800,000 |
| Payments | $150,010,000 | $30,950,000 | $49,740,000 | $230,700,000 |
| Withholding Included | $6,450,000 | $570,000 | $13,670,000 | $20,690,000 |
| Change in Tax | $134,670,000 | $21,860,000 | $66,160,000 | $222,690,000 |
| Change in Interest | $13,240,000 | $5,470,000 | $14,250,000 | $32,960,000 |
| Change in Penalty | $2,670,000 | $3,840,000 | $38,810,000 | $45,320,000 |
| Change in Balance | $380,000 | $240,000 | $69,550,000 | $70,170,000 |
| Balance 6/30/2013 | $270,520,000 | $86,460,000 | $333,990,000 | $690,970,000 |

<table>
<thead>
<tr>
<th>FY End 2013</th>
<th>Self Assessed</th>
<th>Deficiencies</th>
<th>Enforced Filing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Liabilities</td>
<td>224,535</td>
<td>57,310</td>
<td>75,800</td>
<td>357,645</td>
</tr>
<tr>
<td>Balance 6/30/2013</td>
<td>$270,520,000</td>
<td>$86,460,000</td>
<td>$333,990,000</td>
<td>$690,970,000</td>
</tr>
</tbody>
</table>