

# Budget Note Response: Tax Gap and Compliance Strategies

Joint Committee on Ways & Means  
Subcommittee on General Government

February 20, 2014



# 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.

	Tax Return		Estimated True Amounts		Tax Gap	
	Income	Tax	Income	Tax		
State 1	\$ 33,300	\$ 732	\$ 37,000	\$ 880	\$ 148	16.8%
State 2	\$ 33,300	\$ 798	\$ 37,000	\$ 1,020	\$ 222	21.8%



# 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.



# Budget Note Response: Compliance Strategies

How our strategies align with our  
agency mission.



# Overview

- Revenue strategic planning process.
- Context for focus on voluntary compliance.
- Tax compliance strategies and related metrics.



# Agency Mission

We make revenue systems work to fund the public services that preserve and enhance the quality of life for all citizens.

## Action plan goal

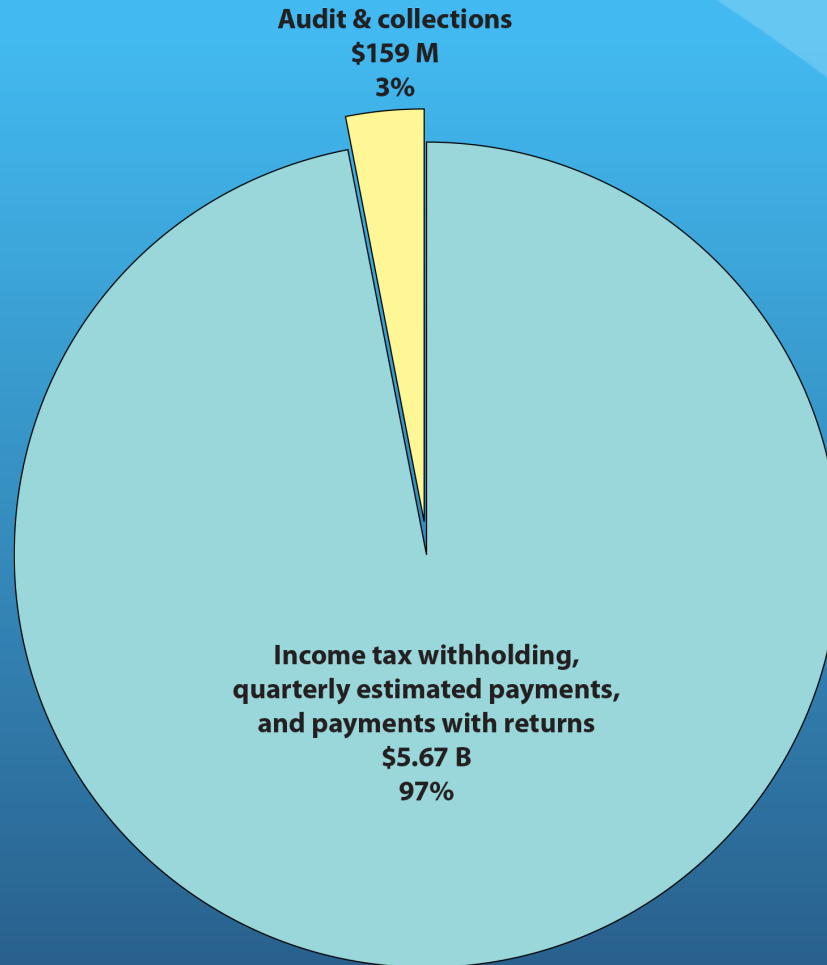
Enhance voluntary compliance and collection of taxes due under law.

“...we will make it as easy as possible for taxpayers to comply, and we will use effective and efficient enforcement tools to assure that everyone pays their fair share under Oregon's tax laws.”



# Personal income tax revenues

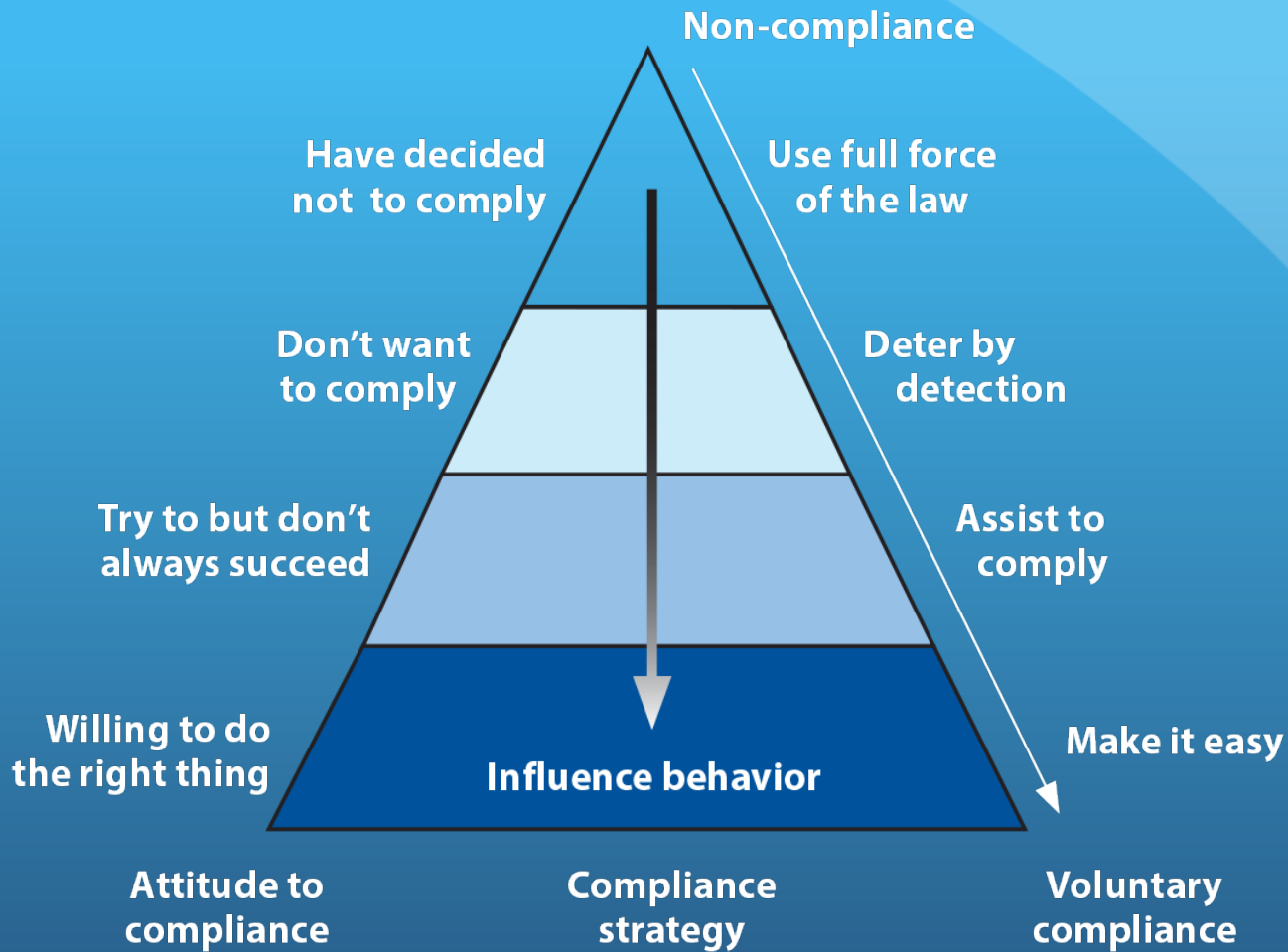
## How they're paid



Fiscal Year 2012  
Source: DOR Research Section



# Create an environment which promotes compliance



**Strategic foundations**

**Outcome areas**

**BUS/PTAC strategies**

**Mission**

We make revenue systems work to fund the public services that preserve and enhance the quality of life for all citizens.

**Vision**

We are a model of 21st century revenue administration through the strength of our people, technology, innovation, and service.

**Values**

- Highly ethical conduct.
- Service and operational excellence.
- Fiscal responsibility.
- Quality in relationships.
- Accountability.
- Continuous improvement.

**Voluntary compliance**

**Create easier ways for people to comply and file**

- Focus on the needs of the customer.
- Use third party data to assist taxpayers.

**Assist taxpayers and tax practitioners with voluntary compliance**

- Use education and assistance to help people comply.
- Understand the factors that influence voluntary compliance.

**Enforcement**

**Focus on greatest areas of risk**

- Risk is used to determine case selection and prioritization.
- Use processing systems for initial return verification.

**Leverage data and systems for enforcement**

- Use data to identify non-compliance (audit, filing enforcement, and collections).
- Leverage partnerships to gain third party information/data.

**Utilize tools and opportunities to enhance enforcement efforts**

- Leverage public perception of noncompliance to enhance compliance with tax laws.
- Maximize public and private partnerships.

**Employee engagement**

**Attract and retain outstanding employees by investing in our staff**

- Employees have access to training, information, and tools needed to do their job.
- Employees know how to be successful at DOR.
- Successes are recognized and celebrated.

**Value employee participation**

- Support staff participation in process re-engineering and process improvement.
- Encourage staff to seek committee involvement.
- Provide opportunities for employees to participate in decision making processes.

**Create a workplace that allows employees to thrive**

- Find opportunities to align business needs with flexible work schedules and telework opportunities.
- All employees are treated fairly, respectfully, and equally.
- Provide opportunity for ideas to be heard and acknowledged.

**Customer experience**

**Customer self-sufficiency**

- Customers have access to do business transactions 24/7.
- Taxpayers have options and know what their options are to meet their needs.
- Our customers have the tools that they need to comply.

**Providing a good "customer experience"**

- Staff understand and provide a good "customer experience."
- Use clear, concise, communications.
- Customers get the assistance they need.
- A clearly articulated service standard is available to the public that sets the expectations.

**Equity & uniformity**

**Develop clear and consistent processes**

- Utilize cross division work groups to create and update shared policies and procedures where they exist.
- Exception processes are documented.

January 2014





# Tax Compliance Performance Measures

- **Filing noncompliance**—The percentage of identified non-filers that we act on (number of non-filers acted on/number of non-filers identified).
- **Underreporting**
  - The percentage of returns suspended for verification that are adjusted (number of returns adjusted/total number of returns adjusted).
  - The percentage of returns selected for audit that are actually adjusted (number of cases with adjustments/total number of cases selected).
- **Payment noncompliance**
  - The percentage of liabilities (individual tax debts) resolved within 90 days from being liquidated and delinquent (number of liabilities resolved within 90 days/total liability count).



# Questions?

If you have additional questions after today please contact:

Jack Ogami  
Administrator, Business Division  
[jack.h.ogami@oregon.gov](mailto:jack.h.ogami@oregon.gov)  
503-945-8030

