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Nationwide Taxes Underpaid by \$450 billion

The IRS says that the total taxes paid in 2006 was lower by a massive \$450 billion compared to what was supposed to have been paid. That comes up to an underpayment of about 17%. 2006 is the latest year for which the IRS has gathered such statistics. The shortfall in taxes far exceeded the size of the entire federal budget deficit that year, which was \$248 billion. However, this amount was reduced to about \$385 billion or 14% after audits and other collection efforts were carried out. This still exceeded the budget deficit, meaning that if the shortfall was actually collected, the budget would have shown a surplus instead of a deficit for 2006.

This figure brought about an immediate reaction from lawmakers who spoke up about the need to revise the tax code to reduce the “tax gap”, the term commonly used to refer to the difference in the amount of taxes that should have been collected and the amount actually collected. Michelle Dimarob (R-Mich), spokeswoman for House Ways and Means Committee Chairman Dave Camp said, “The best way to increase compliance is to reform the tax code to make it simpler”. In Dimarob’s opinion, such a move would cause fewer errors and “greater certainty, which is key to job creation.”

With the ballooning federal budget deficit every year, it is all the more critical to reform the tax code and save money. “In an era when we’re squeezing the federal budget for every dollar of savings, we have to make every effort to recover these lost funds,” said Senate Finance Committee Chairman Max Baucus (D-Mont). The federal budget deficit rose to a record \$1.4 trillion in 2009 and dipped slightly to \$1.3 trillion last year.

The IRS said that out of the \$450 billion taxpayers underpaid that year, about \$376 billion was due to underreporting of income. This amounted to the largest share of the underpayment. The IRS has noted that when stricter regulations are in place, it makes for compliance by taxpayers. For example, when employers are required to submit details of their employees’ wages through W-2s and withhold taxes from employees’ salaries, the percentage of misreporting and underpayment was only 1%. But a massive 56% of underpayment comes from small business owners, landlords of rented properties and businesses that deal with property sales.

The steps taken by the IRS to improve compliance include tightening the regulation and supervision of tax return preparers and increasing the information that must be reported to the agency by stock brokers, mutual fund companies and for certain business transactions. But despite these measures, most industry experts said they do not believe that the compliance rate has changed significantly from the 2006 figures.

This is primarily because the underpayment arises mainly from businesses and individuals whose incomes are difficult to verify.