

Is There a \$290-Billion Tax Gap?

By Ann Rey

Dear Congress:

Subject: Recent IRS Announcement of \$290-Billion Tax Gap

I don't think our federal tax system truly squeezes every last penny out of the collective pockets of small—or any—business. Couldn't you make the federal tax system even more tough and complex to address this: 'Don't you think we need another law?'

Actually, I don't think we need another law, nor would I ever want to see the 17,000-page federal, let alone any state's, tax code become more complex. I know everyone wants to blame the IRS for the tax gap as well as every other tax problem, but in actuality it's only the proverbial messenger (and enforcer) of what Congress dreams up and votes into law each year.

The current message from the IRS is that there's an estimated \$290 billion in unpaid and underreported taxes based on 2001 tax returns. That's the difference between what taxpayers should have paid and what they actually paid on a timely basis.

Earlier this year, one could visualize senators salivating over that number during a finance committee meeting, hoping there was some way to collect every last penny to put into its pork-filled budget. Finance chairman Max Baucus (D-Mont.) and Charles Grassley (R-Iowa) have ordered a tax-gap report from the Joint Tax Committee, vowing to make closing the current gap a priority.

In its presentation to the committee, the IRS claims that individuals underreport business income by an estimated \$109 billion. Of that, \$68 billion is attributed to under-reporting by Schedule C filers or sole proprietors, with the balance (\$127 billion) due from large corporations and from other taxes, including employment and real estate taxes.

Granted, there are probably a fair number of individuals who underreport

or actually try to not pay taxes. This is an injustice to honest taxpayers.

The initial estimate of taxes actually collected for 2001 was \$2.1 trillion from 130 million returns. The estimated tax receipts for 2005 is \$2.2 trillion. Overall compliance remains above 85% for a national tax system that is based on voluntary compliance!

Various finance committees hold these hearings and hear a similar story every year, however, the estimate just seems to get bigger. Before these esteemed legislators figure out how to collect this \$290 billion (and waste our money, once again, in coming up with a plan), would they please try to do their own taxes as individuals without any assistance, and then try to do the taxes for a small business with, say (let's make it simple), less than a million dollars in revenue, operating in one state (their own), and with five employees.

After they complete that exercise, now tell us that there are more companies out there cheating on their taxes than those who just don't understand the instructions and complexities of what is needed to complete a return. Granted, the majority (estimates are over 60%) of individuals no longer do their own taxes because of how difficult it is, which probably means that almost all small businesses have an accountant do theirs. However, at least two small propane marketers told *BPN* recently that they usually see deductions, and often other items, missed or forgotten when they review their tax returns with their accountant.

Several small propane marketers graciously provided a peek at how much work is involved in doing their federal returns. A marketer filing as a C-corporation said the federal return was at least 25 pages: the company's bookkeeper does the leg work in-house before turning over the information to the CPA. That company's state tax return is generally under 10 pages. A marketer, who is in a much less business-friendly state and filing as an S-corporation, has a federal tax return that is closer to 30 pages, while its state return is just under 30 pages. That company also uses a bookkeeper to prepare the information for a CPA.

As a comparison, a presidential candidate only has to fill out a four-page document, including name, bank ac-

count number, fax number, website, and name of the custodian of his or her records, once every four years.

Why does a presidential candidate—someone who could potentially oversee this country's multi-trillion-dollar budget annually, along with several other responsibilities, for four years—have to provide less information?

In the IRS report, the agency acknowledged that auditors have found that an estimated 94% of noncompliance is the result of honest mistakes by tax filers (and preparers) who simply don't understand the 17,000-page tax code. DUH! However, it intends to target small businesses with increased scrutiny and audits.

In looking at the Schedule C filers or sole proprietors, the IRS says that in 2001, there were 20.6 million individual tax returns reporting non-farm income in this category. Two-thirds of these businesses are very small, with about 13 million having gross sales of \$25,000 or less. If one includes those with sales of up to \$100,000, the total rises to nearly 17 million.

In addition to acknowledging the complexity of doing one's taxes, the IRS reported that it needs to enhance its outreach to small businesses (500 or fewer employees) and the self-employed. The Small Business/Self-Employed division of the IRS was recently reorganized as part of IRS' efforts to better address its concerns with this group of taxpayers, which the agency estimates is about 45 million strong and which it says created 60% to 80% of net new jobs over the past decade.

Why go after small businesses simply because they are easier to pursue than it is to simplify the tax code, which Congress neither has the brains nor the collective backbone to do? While a simpler tax code would make it easier for taxpayers to comply, the logic in Washington is to come up with more regulations and hire more bureaucrats to enforce them.

The ramifications of ramping up regulations and enforcement should remind everyone of the chilling testimony from previous congressional hearings over the IRS' enforcement efforts (and abuse).