



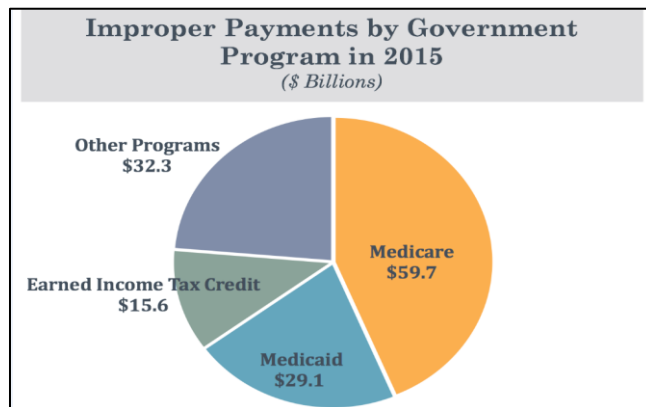
Budget Digest – Week of February 13th

IMPROPER GOVERNMENT PAYMENTS AND THE TAX GAP

Every year, the Federal Government makes tens of billions of dollars in improper payments and fails to collect hundreds of billions of dollars in legally due taxes. Both are longstanding problems that, if addressed, could help lawmakers gain more control over Washington's unsustainable fiscal outlook.

How large are improper government payments? Improper payments are defined as those made in incorrect amounts (mostly overpayments), to the wrong entity, or for the wrong reason. The Government Accountability Office [GAO] says these payments totaled \$136.7 billion in fiscal year 2015, nearly four times the amount in 2003 (\$35 billion), when agencies first began estimating them.

Payment errors in 2015 occurred in roughly 120 government programs across 22 agencies, but three-quarters of them were in three programs: Medicare, Medicaid, and the Earned Income Tax Credit [EITC]. The EITC error rate reached nearly 25 percent in 2015.



What is the 'Tax Gap'? The so-called tax gap is the difference between what taxpayers legally owe to the Treasury and what they actually pay in taxes. The Internal Revenue Service [IRS] estimates the annual gross tax gap is \$458 billion, and that it has three general causes: the underreporting of true tax liabilities, the underpayment of taxes due, and the failure of some taxpayers to file returns. About \$52 billion of the tax gap will eventually be recovered through voluntary late payments and enforcement activities (e.g. audits), the IRS says, leaving a net tax gap of \$406 billion. Roughly 70 percent of that amount comes from the individual income tax, centering on the underreporting of taxpayers' true liabilities. Experts suggest the sheer complexity of the tax code contributes significantly to the problem.

Solutions? Neither problem lends itself to easy, silver-bullet solutions, but both must be addressed. Congress needs to hold departments and agencies accountable for chronic overpayments and create incentives for more careful management of government resources – as opposed to the “get-the-checks-out-the-door” mentality that leads to wasteful spending. Simplifying the tax code through fundamental tax reform could help facilitate more accurate tax returns, streamline tax administration, and recoup much more of the annual tax gap.