

Tax Gap Estimate

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The Tax Gap: The difference between what is properly owed to the state and what is voluntarily reported and paid timely



The Problem Defined

- Portions of the Gap are measureable
 - Filing Enforcement
 - Audit Program



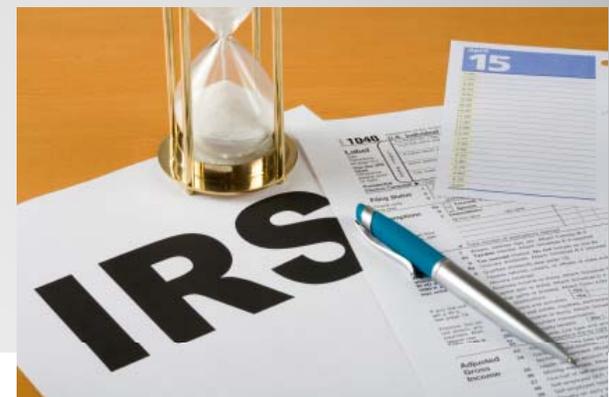
- A large portion, however, is not easily identifiable
 - Non-filing
 - Understatement of income
 - Overstatement of deductions

Measuring The Tax Gap

Extensive IRS Study

- Using the 2001 tax year
- Involved detailed analysis of several thousand IRS audits
- Identified areas of non compliance
- Extrapolated these results to the overall population
- Determined that the federal gross tax gap (before enforcement and late payments) was \$310 billion for the 2001 tax year

Prior Studies



Prior CA Estimate (Economic & Statistical Research Bureau)

- Used IRS study as a foundation
- Assumed similar tax gaps for our various categories of taxpayers
- Made adjustments specific to CA
- Estimated that based on the IRS study for the 2001 tax year, if similar gaps applied-- CA's tax gap approximated \$6.5 billion in FY 04/05



Prior California Estimate

New IRS Study

- Using the 2006 tax year, the IRS conducted a similar study to update its estimate of the federal tax gap
- The IRS found that the federal gross tax gap has grown from \$310 billion in 2001 to \$450 billion in 2006
- Study shows that compliance rates have remained fairly stable
- Growth in the tax gap largely mirrored growth in tax liabilities



New IRS Study

New CA Estimate

- ESRB has taken the new IRS study
- We continue to assume similar tax gaps and to apply them to our various categories of taxpayers
- Allowed for the same CA specific adjustments
- Estimate that based on the IRS study for the 2006 tax year, if similar gaps applied-- CA's tax gap is approximately \$10 billion in FY 10/11



Updated California Estimate

- \$10 billion is a large number
 - This estimate is based on a specific point in time—2006 tax year and applied to FY 10/11
 - The impact of the current economic conditions on compliance rates and other impacts have not fully been taken into account because the federal study was based on 2006 data
- The correlation between growth in the tax gap and growth in liabilities means we are likely to see the gap increase as the economy recovers
- Closing the gap has been and will continue to be a focus of FTB
- Efforts such as EDR are critical towards narrowing the gap

Takeaways