

SUMMARY
Estimated Future Tax Evasion under the Income Tax System and Prospects for Tax Evasion under the FairTax: New Perspectives

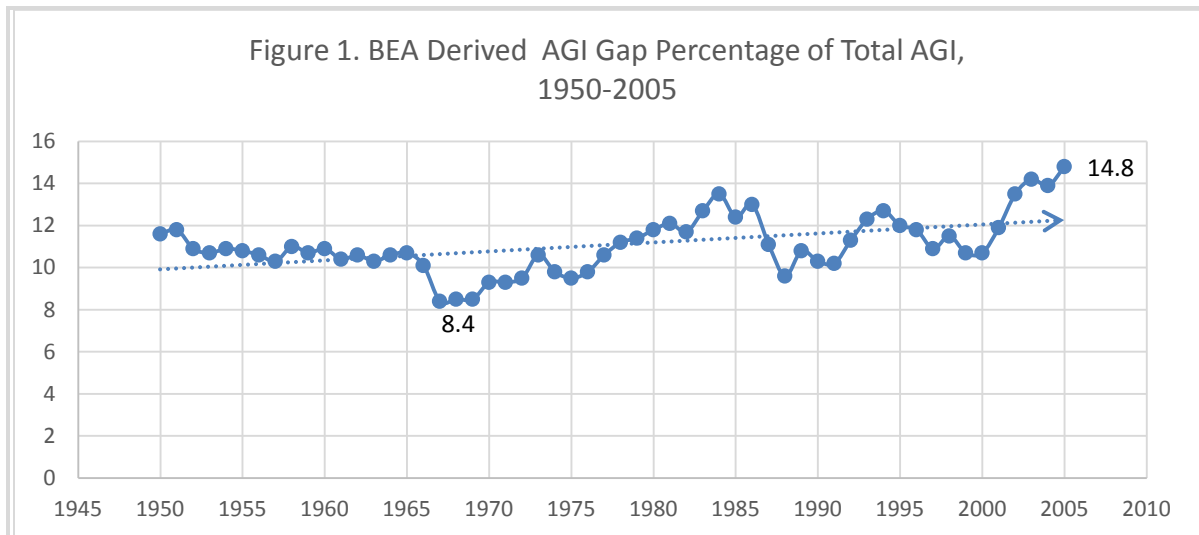
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Purpose of Study

1. The Evasion study examines tax evasion, looking at historical rates of evasion and then estimating future tax evasion over the next decade, 2017 to 2026.

- a) The authors focus on the underreporting of income. They compare total personal income as derived by the U.S. Bureau of Economic Analysis and contained in the National Income Product Accounts (NIPA)¹ to total income reported to the IRS contained in the Statistics of Income data: BEA-derived Adjusted Gross Income to IRS Adjusted Gross Income. Historically, the underreporting of income had a low of 8.4% in 1967 and reached a high of 14.8% in 2005. (The last year BEA conducted the study).



- b) The authors next step is to forecast income tax evasion in the form income underreporting – the AGI Gap. They use three different growth rates: evasion growing at the rate of inflation (2.703%), evasion growing at the rate of the nominal GDP growth rate (4.85%), and evasion growing at the historical evasion growth rate of (7.034%).

¹ NIPA is the same data that is used to estimate taxable consumption under the FairTax.

Table 4 shows that the total AGI Gap (income underreported to the IRS) over the next decade is \$32.730.3 trillion for 2017-2026. This amount is 77.4%-81.4% larger than the size of US GDP in 2015-2016 (\$18.04 - \$18.45 trillion in current dollars).

Table 4. New Estimates of the AGI Gap in Current Dollars Using Alternative Actual Annual Percentage Growth Rates (% GRs), 2017-2026

Tax Year	Inflation (2.703%)	NGDP GR (4.850%)	AGI Gap GR (7.034%)
2017	1,622.10	1,901.80	2,365.10
2018	1,665.90	1,994.00	2,531.50
2019	1,711.00	2,090.70	2,709.60
2020	1,757.20	2,192.10	2,900.20
2021	1,804.70	2,298.40	3,104.20
2022	1,853.50	2,409.90	3,322.50
2023	1,903.60	2,526.80	3,556.20
2024	1,955.10	2,649.30	3,806.30
2025	2,007.90	2,777.80	4,074.10
2026	2,062.20	2,912.50	4,360.70
2017 to 2026	\$18,343.30	\$23,753.40	\$32,730.30

Sources: BLS, BEA and BEA's Ledbetter (2004; 2007)

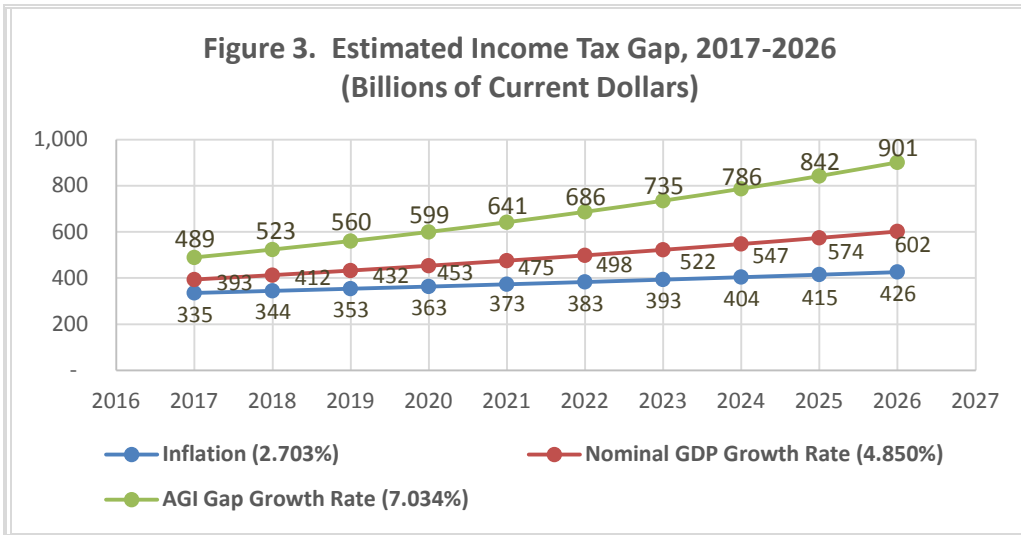
Table 5.1 shows the lost income tax revenues, Income Tax Gap, which is calculated by multiplying the projected underreported income in Table 4 times 20.66%, the average federal income tax rate. Table graphed in Figure 3.

Table 5.1 Estimated Income Tax Gap, 2017-2026, Billions of Current Dollars, Federal Income Tax Rate of 20.66%*

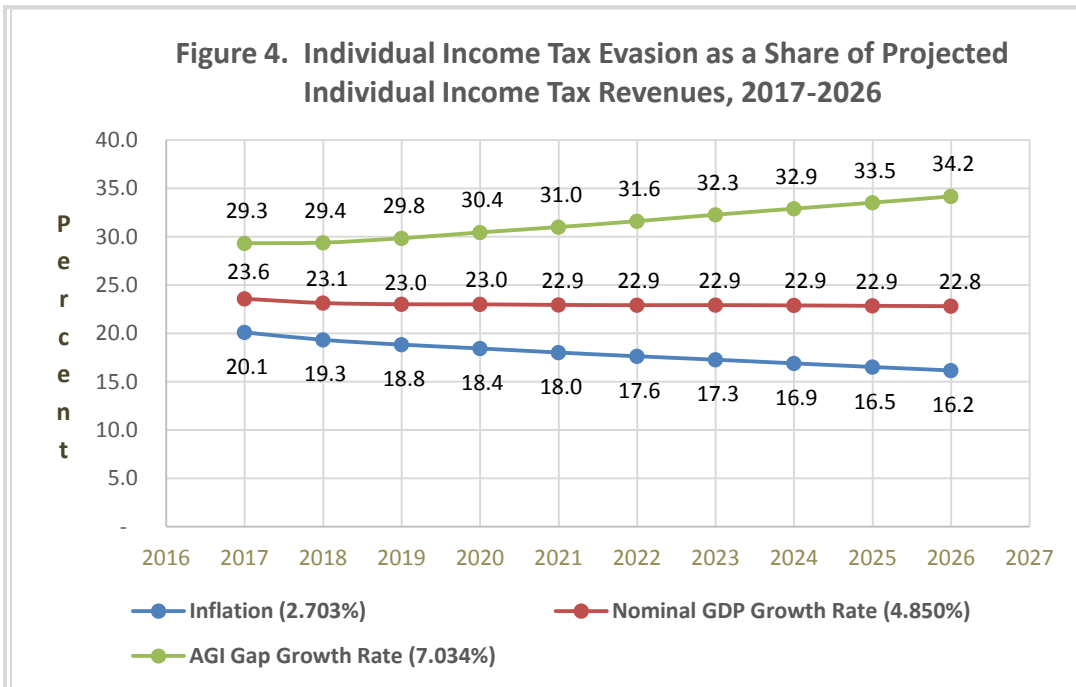
Tax Year	(1) Inflation (2.703%)	(2) NGDP GR (4.850%)	(3) AGI Gap GR (7.034%)
2017	335.1	392.9	488.6
2018	344.2	412.0	523.0
2019	353.5	431.9	559.8
2020	363.0	452.9	599.2
2021	372.9	474.9	641.3
2022	382.9	497.9	686.4
2023	393.3	522.0	734.7
2024	403.9	547.4	786.4
2025	414.8	573.9	841.7
2026	426.0	601.7	900.9
2017 to 2026	\$3,789.7	\$4,907.4	\$6,762.1

*Sources: Table 9; IRS (1996, p. 9; 2016, p. 2)

The anticipated Individual Income Tax Gap to be faced by the IRS falls in the range of between 3.8 trillion and nearly 6.8 trillion dollars.



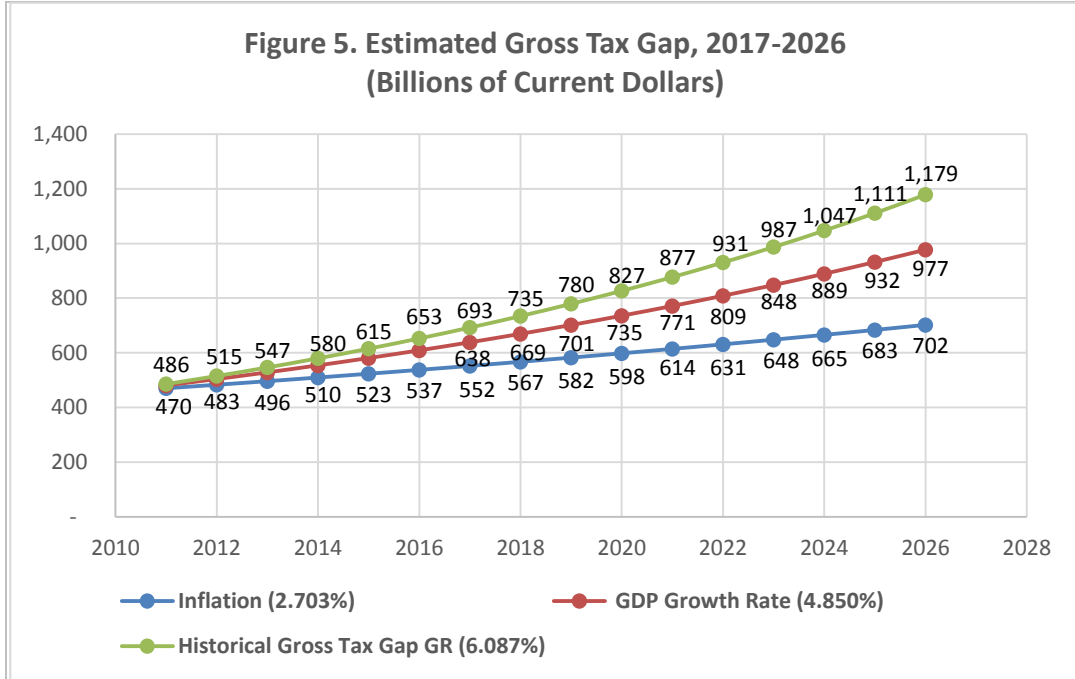
c) The authors compare the forecasted income tax evasion to total income tax revenues, again using the three different growth rates. On average, the annual share varies from 16.2% to 34.2% for the time period from 2017-2026. Individual Income Tax evasion from 2017 to 2026 will persist above the 16% level. **Based on historic growth rates (which is the more likely to occur scenario), income tax evasion will grow from 29.3% of income tax revenues in 2017 to 34.2% by 2026—exceeding one third of income tax revenues.**



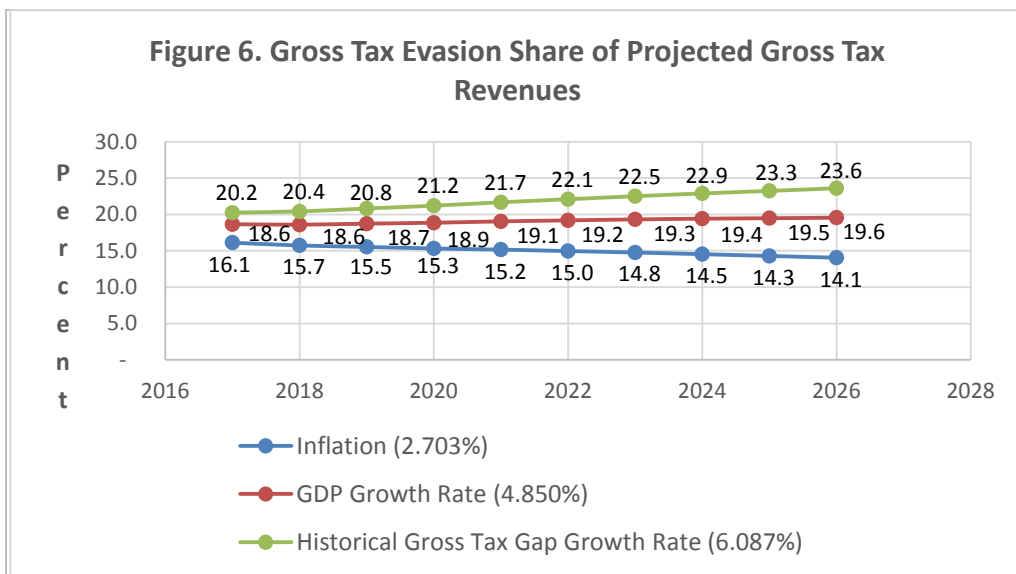
d) The next step is to look at the history and generate a forecast of what is generally known as the IRS Tax Gap – this is the taxes owed but not paid timely. It consists of nonfiling, underreporting, and underpayment. It includes all federal taxes: individual and business income taxes, payroll taxes, capital gains taxes, estate taxes and excise taxes.

Total tax evasion (all federal taxes) will increase from year to year and based on historic trends will increase from an estimated 20.2% in 2017 to 23.6% in 2026 of gross tax revenues by 2026.

Based on historical trends, cumulative tax evasion from the federal income tax system over the next decade (2017-2026) will reach about 9 trillion dollars.

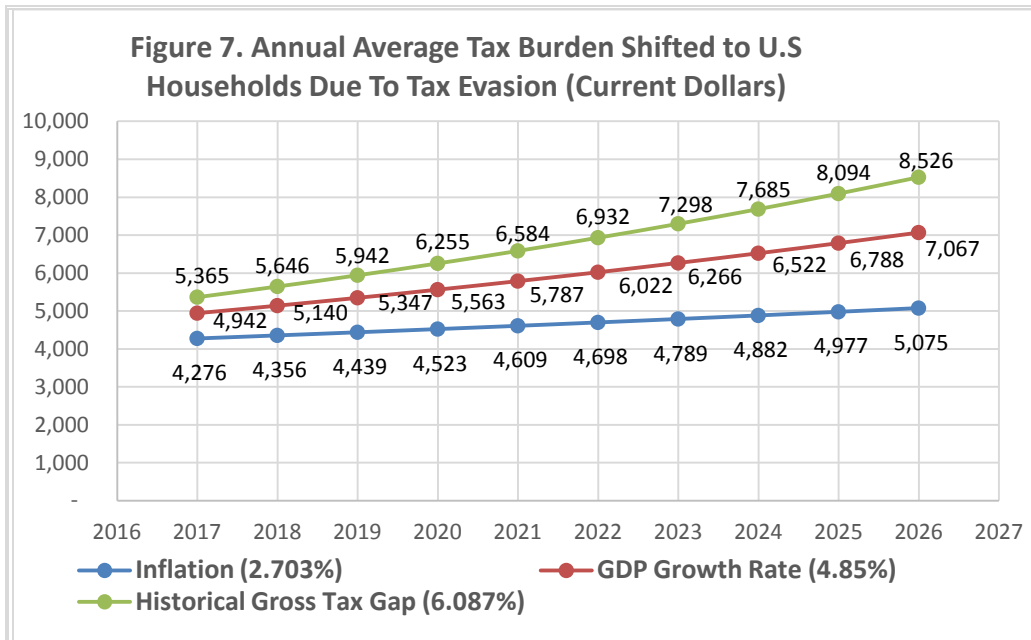


e) As with the income tax gap, the Total Tax Gap as a % of Total Taxes is computed. Based on historic trends, the Total Tax Gap, on average, as a percent of total tax revenue, will increase from year to year starting at 20.2% and reaching 23.6% by 2026.



- f) The authors compute the amount of tax burden that is effectively shifted from the tax scofflaws to those who pay their taxes. This is done by dividing the Total Tax Gap by the number of households for that year. The yearly population forecast was divided by 2.53 (the average persons per household) to get the number of households.

Based on the historical growth of the gross tax gap, the average tax burden shifted per household grows from \$5,365 in 2017 to \$8,526 in 2026. This “surtax” enables the federal government to raise the same level of revenue it would collect if all taxpayers were to report their income and pay their taxes in full.



The cumulative tax burden shifted from tax scofflaws to compliant taxpayers amounts to a total estimated burden of between \$46,623 and \$68,328 over the ten-year period from 2017-2026, which is comparable in size, if not greater, under the historical growth rate scenario, to both the median and mean household income in the U.S. in 2015.

In other words, in one out of the 10 years ahead each American household will be working solely to pay off the 10-year overall “surtax”—arguably a heavy burden for every household.

2. The study looks at various trends in the economy and whether they would tend to increase or decrease tax evasion.
3. Model of transactions costs associated with the decision to evade the FairTax: time and energy, a conscience cost (knowing that you are doing wrong), potential cost of penalties if caught, and the cost of finding someone to collude with you and agree not to collect or pay the tax.

4. Practical considerations of the FairTax reducing evasion: 80% reduction in number of tax filers, and the dominance of large companies in the wholesale and retail sectors.

Table 13 shows that while small businesses make up 64.7% of wholesale and retail trade corporations, their combined business receipts represent only 2.1% of total wholesale and retail trade business receipts.

Table 13. Distribution of Wholesale and Retail Trade Corporations by Size of Business Receipts, 2012

Size of Business Receipts	Total Returns	Business Receipts	Percent of Returns	Percent of Receipts
(Money amounts thousands of dollars and size of business receipts is in whole dollars)				
Under \$25,000	147,400	\$784,540	15.40%	0.00%
\$25,000 to \$100,000	106,865	\$6,104,331	11.10%	0.10%
\$100,000 to \$250,000	145,023	\$24,100,652	15.10%	0.30%
\$250,000 to \$500,000	126,027	\$45,284,628	13.10%	0.60%
\$500,000 to \$1,000,000	121,775	\$86,165,220	12.70%	1.10%
Small Business Subtotal	647,090	162,439,371	67.40%	2.10%
\$1,000,000 to \$2,500,000	137,559	\$219,076,744	14.30%	2.80%
\$2,500,000 to \$5,000,000	73,809	\$259,165,989	7.70%	3.30%
\$5,000,000 to \$10,000,000	42,293	\$297,656,068	4.40%	3.80%
\$10,000,000 to \$50,000,000	45,979	\$954,027,758	4.80%	12.20%
\$50,000,000 to \$100,000,000	7,111	\$497,301,653	0.70%	6.40%
\$100,000,000 to \$250,000,000	3,741	\$557,800,877	0.40%	7.10%
\$250,000,000 or more	2,167	\$4,862,482,246	0.20%	62.30%
Total Active Corporations	959,749	7,809,950,706	100.00%	100.00%

Source: Calculations based on IRS, RETURNS OF ACTIVE CORPORATIONS, Table 5--Selected Balance Sheet, Income Statement and Tax Items, by Sector, by Size of Business, Tax Year 2012. All figures are estimates based on samples.