GAO Highlights

Highlights of GAO-16-92T, a testimony before the Committee on Finance, U.S. Senate

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FISCAL OUTLOOK

Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position

Why GAO Did This Study

The federal government continues to face an unsustainable long-term fiscal path. Changing this path will require difficult fiscal policy decisions to alter both long-term federal spending and revenue. In the near term, executive branch agencies and Congress can take action to improve the government's fiscal position by addressing two long-standing issues—improper payments and the tax gap. Over time, these issues involve amounts near or exceeding $1 trillion.

Over the past decade, GAO has highlighted the issue of improper payments—defined by statute as payments that should not have been made or that were made in an incorrect amount (including overpayments and underpayments). GAO has reported for several years that the federal government is unable to determine the full extent to which improper payments occur and reasonably assure that actions are taken to reduce them.

The tax gap is the difference between taxes owed and those paid on time, as a result of taxpayers underreporting their tax liability, underpaying taxes, or not filing tax returns. Reducing the tax gap could provide additional revenue.

This statement discusses (1) actions needed to address improper payments government-wide and (2) strategies to reduce the tax gap. It is based on GAO's recent work on improper payments, agency financial reports and inspectors general reports, and prior reports on the tax gap, including those with open recommendations or matters for congressional consideration that could potentially help reduce the tax gap.

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What GAO Found

A number of strategies, including implementing preventive controls and addressing GAO's prior recommendations, can help agencies reduce improper payments, which have been a persistent, government-wide issue. The improper payment estimate, attributable to 124 programs across 22 agencies in fiscal year 2014, was $124.7 billion, up from $105.8 billion in fiscal year 2013. The almost $19 billion increase was primarily due to the Medicare, Medicaid, and Earned Income Tax Credit programs, which account for over 75 percent of the government-wide improper payment estimate. Federal spending in Medicare and Medicaid is expected to significantly increase, so it is critical that actions are taken to reduce improper payments in these programs. Moreover, for fiscal year 2014, federal entities reported estimated error rates for 10 risk-susceptible programs that exceeded 10 percent. Recent laws and guidance have focused attention on improper payments, but incomplete or understated estimates and noncompliance with criteria listed in federal law hinder the government's ability to assess the full extent of improper payments and implement strategies to reduce them. For example, for fiscal year 2014, 2 federal agencies did not report improper payment estimates for 4 risk-susceptible programs, and 5 programs with improper payment estimates greater than $1 billion were noncompliant with federal requirements for 3 consecutive years. Identifying root causes of improper payments can help agencies target corrective actions, and GAO has made numerous recommendations that could help reduce improper payments. For example, strengthening verification of Medicare providers and suppliers could help reduce improper payments. GAO has stated that continued agency attention is needed to (1) identify susceptible programs, (2) develop reliable estimation methodologies, (3) report as required, and (4) implement effective corrective actions based on root cause analysis. Absent such continued efforts, the federal government cannot be assured that taxpayer funds are adequately safeguarded.

Addressing the estimated $385 billion net tax gap will require strategies on multiple fronts. Key factors that contribute to the tax gap include limited third-party reporting, resource trade-offs, and tax code complexity. For example, the extent to which individual taxpayers accurately report their income is correlated to the extent to which the income is reported to them and the Internal Revenue Service (IRS) by third parties. Where there is little or no information reporting, such as with business income, taxpayers tend to significantly misreport their income. GAO has many open recommendations to reduce the tax gap. For example, GAO recommended in 2012 that IRS use return on investment data to reallocate its enforcement resources and potentially increase revenues. Since 2011, GAO also recommended improvements to telephone and online services to help IRS deliver high-quality services to taxpayers who wish to comply with tax laws but do not understand their obligations. Other strategies GAO has suggested would require legislative actions, such as accelerating W-2 filing deadlines. Additionally, requiring partnerships and corporations to electronically file tax returns could help IRS reduce return processing costs and focus its examinations more on noncompliant taxpayers. Further, a broader opportunity to address the tax gap involves simplifying the Internal Revenue Code, as complexity can cause taxpayer confusion and provide opportunities to hide willful noncompliance.