

*Tax Noncompliance and Measures of Income  
Inequality\**

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\*The views expressed here are solely those of the authors and do not reflect the opinions of the U.S. Department of the Treasury or the Office of Tax Analysis.

# BACKGROUND

- From Piketty and Saez (2003) to Auten and Splinter (2017), measuring inequality using tax data has been a topic of interest
- Research into the tax gap by the IRS and OTA has found that quite a bit of income is misreported in the published data
- What we don't know is how these two pieces of information interact

# THEORY

- No clear predictions on where we should expect to find misreporting
- Taxpayers with high incomes generally have more complex returns with more opportunities to misreport
- Taxpayers with low incomes might have more incentive to misreport, or might not have low incomes in reality

## PREVIOUS LITERATURE

- Using the inaugural wave of the NRP, Johns and Slemrod (2010) found that while misreporting increases with income, the post-audit Gini coefficient is lower
- Auten and Splinter (2017) finds that incorporating audit data decreases inequality measures
- Alstadsæter, Johannesen, and Zucman (2017) shows how very high income individuals may be underreporting their income

# DATA

- National Research Program (NRP)
  - Randomized
  - Representative
  - In-Depth
- Cross-sectional data for 2006-2014
- Oversampling for business income

# DATA LIMITATIONS

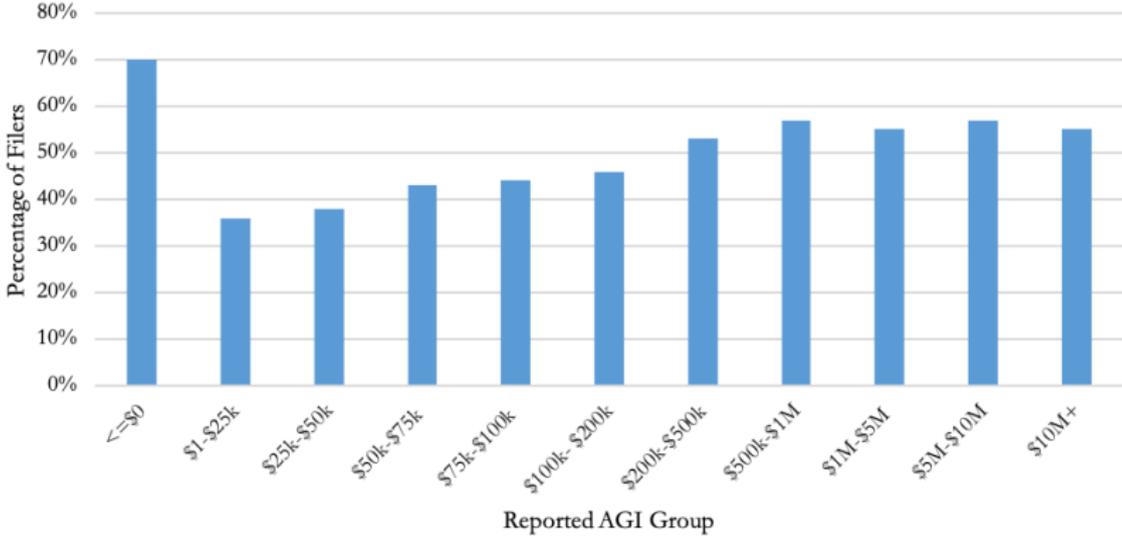
- Not all noncompliance is captured by NRP
  - Offshore accounts
  - Cash income
- Detection Controlled Estimation (DCE)
  - Attempts to correct for variation in examiner quality, harder to detect income
  - Still unable to incorporate offshore accounts, easily hidden cash income
  - Affects scale of non-compliance, but not (to a great extent) the distribution
  - Aggregation over filers and line items makes it difficult to use for inequality measures
  - *Excluded from the results here*

# OVERALL FINDINGS

- Higher income individuals are generally more likely to misreport
- Higher income individuals have larger amounts that are misreported, but they are small compared to their overall income
- This results in small but statistically significant reductions in the Gini coefficient

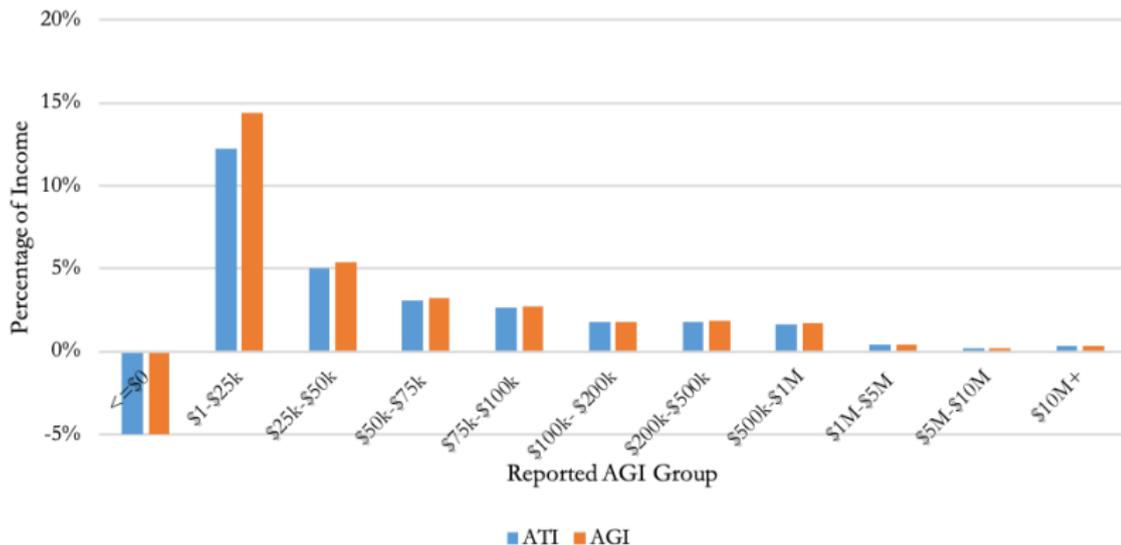
# AUDIT ADJUSTMENTS BY INCOME GROUP

Figure 1: Fraction of Tax Filers with Audit Adjustments by Reported AGI Group



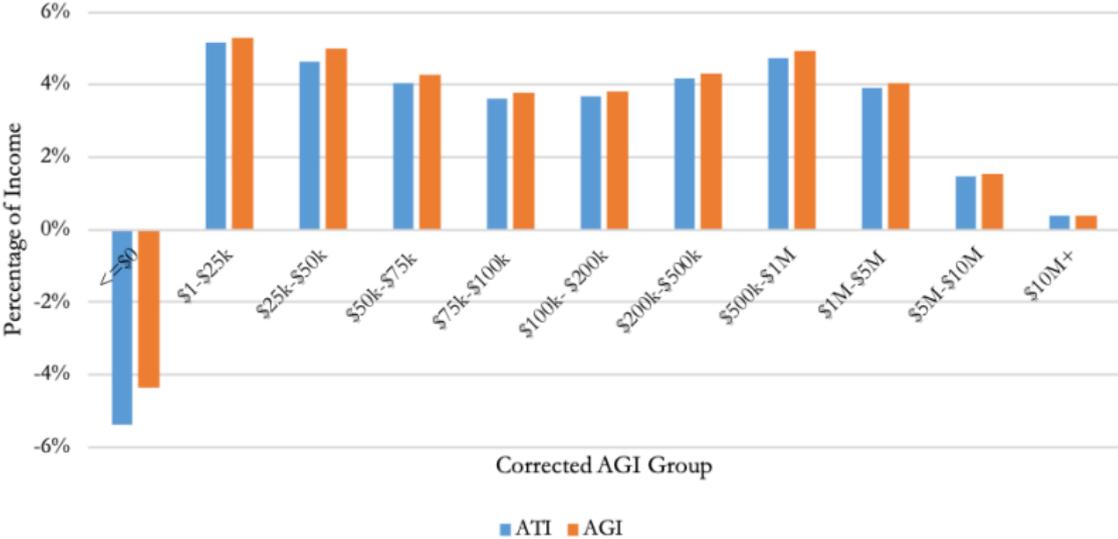
# AUDIT ADJUSTMENTS BY INCOME GROUP – REPORTED INCOME

Figure 2: Audit Adjustments as a Fraction of ATI and AGI, by Reported AGI Group



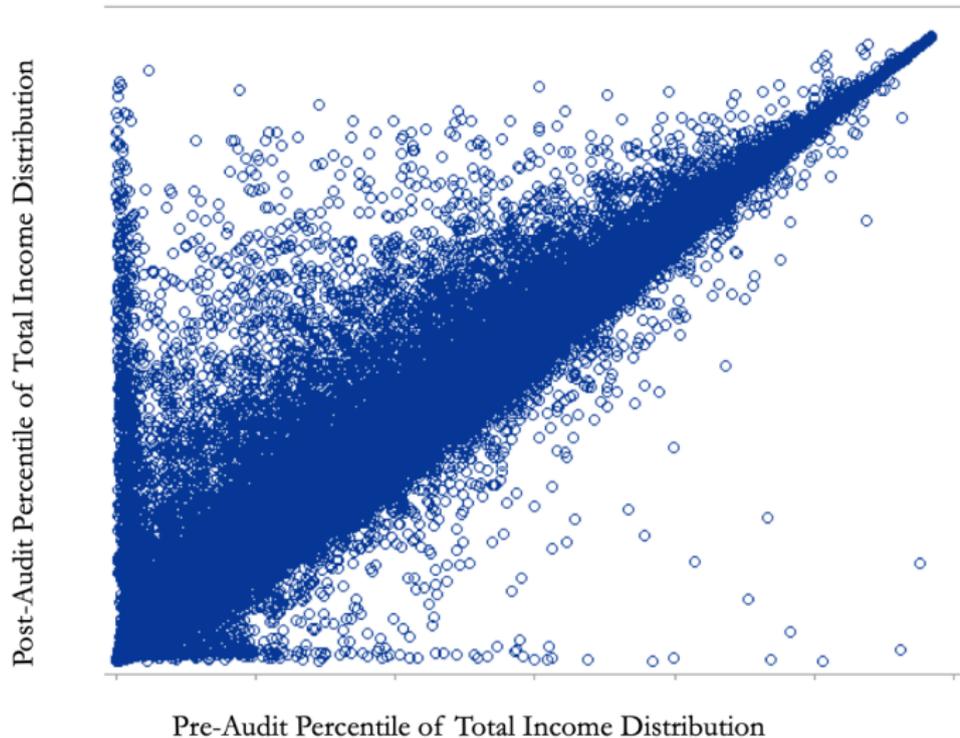
# AUDIT ADJUSTMENTS BY INCOME GROUP – CORRECTED INCOME

Figure 4: Audit Adjustments as a Fraction of AGI, by Corrected AGI Group



# PERCENTILE RANKINGS - BEFORE AND AFTER AUDIT

Figure: Income Percentiles, Pre and Post Audit



# ROLE OF NONCOMPLIANCE ON INEQUALITY

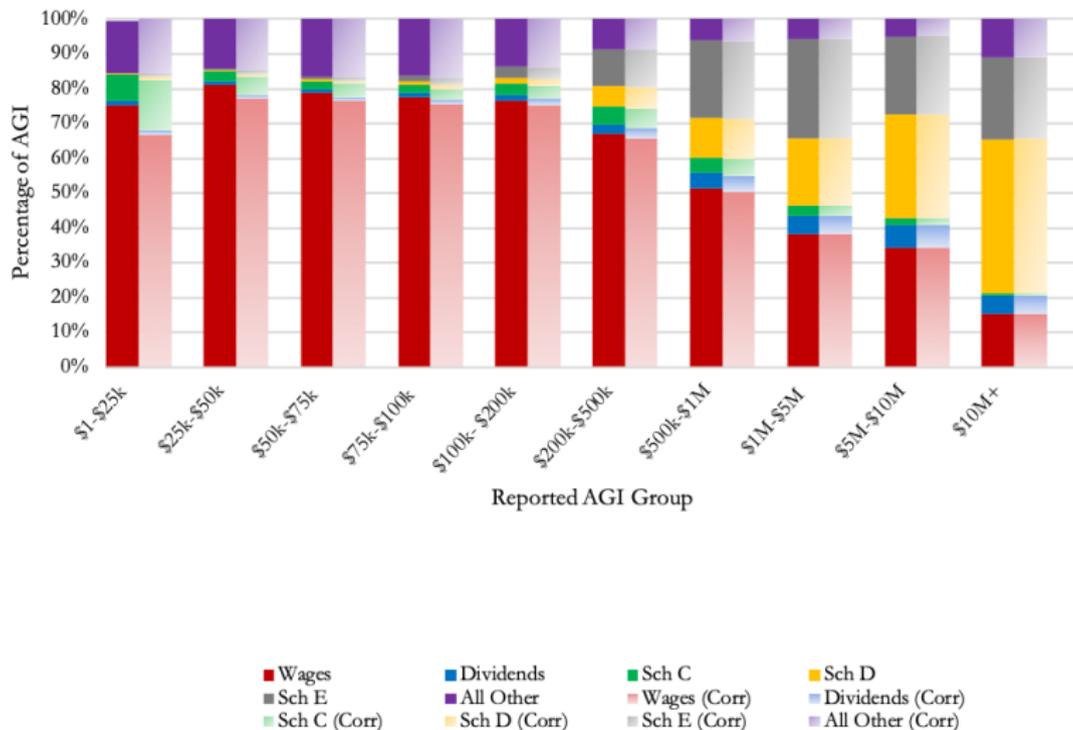
TABLE: Inequality Measures Before and After Audit

Income Definition	Gini Coefficient		Top 1% Share	
	Before Audit	After Audit	Before Audit	After Audit
Adjusted Total Income	0.570	0.563	0.185	0.182
Adjusted Gross Income	0.589	0.582	0.188	0.185
Taxable Income	0.712	0.693	0.244	0.233
Wages and Salaries	0.617	0.616	0.132	0.131
Dividends	0.973	0.972	0.673	0.667
Sch C Income	0.966	0.958	0.554	0.490
Sch D Income	0.994	0.993	0.907	0.893
Sch E Income	0.989	0.988	0.825	0.805

Source: IRS National Research Program, 2006-2014

# INCOME COMPOSITION EFFECTS

Figure 5: Composition of Income Before and After Audit, by Reported AGI Group



# CONCLUSION

- Higher income individuals are generally more likely to misreport
- Higher income individuals have larger amounts that are misreported, but they are small compared to their overall income
- This results in small but statistically significant reductions in the Gini coefficient

# COMPARISON WITH JOHNS AND SLEMROD (2010)

