



MINNESOTA • REVENUE

Individual Income
Tax Gap

Tax Year 1999

June 7, 2004



Acknowledgements

In addition to the contributions to this study that were made by more than a few people at the Minnesota Department of Revenue, we would like to acknowledge the considerable assistance of Tom Gillaspay, Minnesota State Demographer; John Peloquin, Minnesota Department of Finance; Aamir Gangji, intern, University of Minnesota; and Clyde Thurston and Alan Plumley, Internal Revenue Service.

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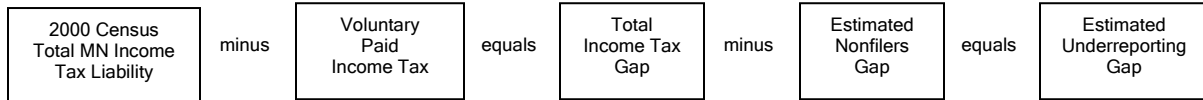
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Introduction and Executive Summary

A tax gap is the difference between the total tax actually collected and the amount that would have been collected if all those required to pay had paid the correct amount of tax. This report investigates the income tax gap for Minnesota in 1999. The research is intended not only to supply an estimate of the 1999 gap, but also to develop and apply a methodology that can be used on an ongoing basis to calculate income tax gap amounts over time.

There are at least two reasons to investigate a tax gap. Noncompliance costs the state revenue that could be used to provide services to Minnesotans. It also undermines the equity and efficiency of the tax system by increasing administrative costs and by unfairly shifting the tax burden to those who do comply.

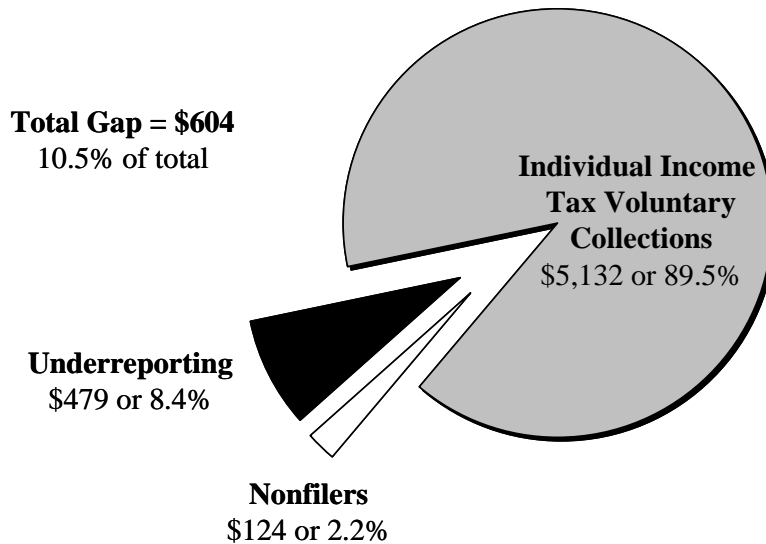
The income tax gap consists of two parts: tax amounts due from those who did not file a tax return (nonfilers,) and the additional tax amounts that should have been paid by those who did file, but reported less than their full tax liability (underreporters).



In 1999, Minnesota's total income tax gap is estimated to have been almost \$604 million, of which nearly \$125 million is attributable to nonfilers and more than \$ 479 million to underreporting.

Amounts in figures and tables may not equal totals due to rounding.

Minnesota Individual Income Tax As Percent of Total Tax Due Calendar Year 1999 (\$ Millions)



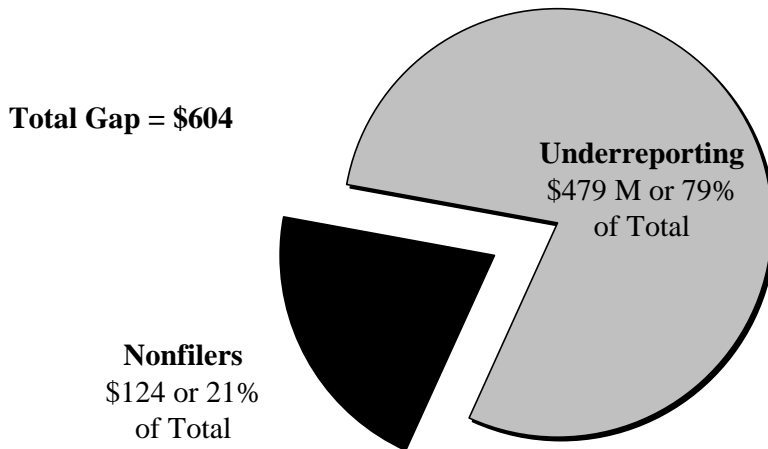
Nearly 670,000 possible filers (individuals and married couples) were responsible for this shortfall. We estimate that 314,000 returns should have been filed that were not, and another 356,000 returns underreported.

Underreporting as used in this study is a net concept. Some people underreport income and tax liability, and a smaller number overreport. Figures given in this study refer to the difference between the two. Also, the number of nonfilers includes those who received a payment statement such as a W-2 and who would have been entitled to a refund of amounts withheld had they filed a return.

The study also distinguishes between the tax gap attributable to wage income and that attributable to all other income (nonwage income). Nonwage income is primarily business income from sole proprietorships, investment income and rents. It is likely that the degree of tax compliance varies with the type of income received. For income types such as wages, where there is independent documentation of amounts received, the degree of compliance is likely to be higher than for income types, such as farm income or self-employment income, where no such record exists, and indeed, that pattern does appear in available data.

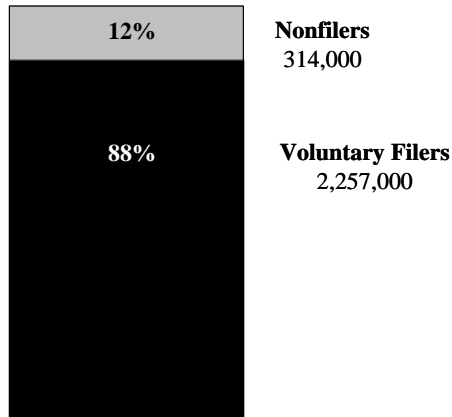
The results described here depend in large part on data from the 2000 census. We anticipate that data for the same variables will be available in noncensus years from the American Community Survey, an annual survey project recently implemented by the Bureau of the Census.

**Minnesota Individual Income Tax
Components of Noncompliance
Tax Year 1999
(\$ Millions)**



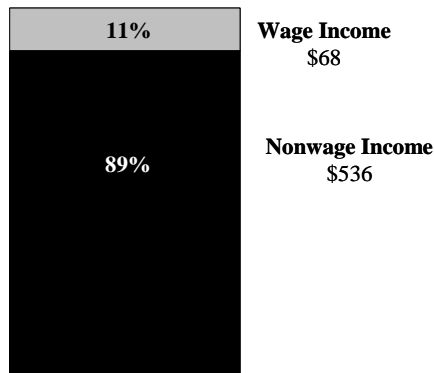
Minnesota Individual Income Tax Filers Tax Year 1999

Total Estimated Filers
2,571,000



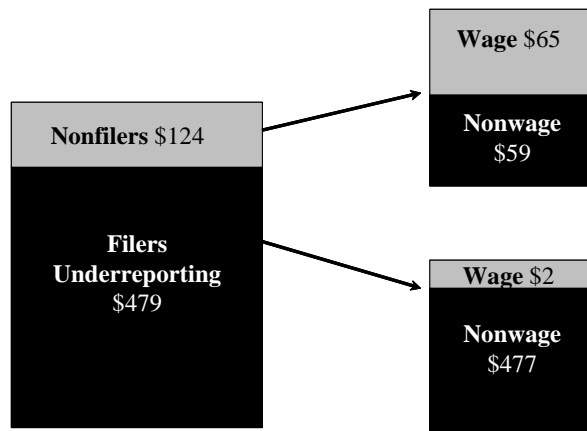
Minnesota Individual Income Tax Gap By Income Components Tax Year 1999 (\$ Millions)

Total Gap
\$604



Minnesota Individual Income Tax Gap By Components and Income Source Tax Year 1999 (\$ Millions)

Total Gap
\$604



Detailed Results Tables

The following tables show the distribution of the income tax gap by total income level.

Minnesota Individual Income Tax Gap Tax Year 1999

FAGI	Tax Gap - (\$1,000's)			Nonfilers - (\$1,000's)			Underreporting - (\$1,000's)		
	Total	Wage	Nonwage	Total	Wage	Nonwage	Total	Wage	Nonwage
< \$4,999	\$422	\$6	\$416	\$57	\$6	\$51	\$365	\$0	\$365
\$5,000 - 9,999	2,188	916	1,272	1,097	891	206	1,091	25	1,066
10,000 - 19,999	25,681	13,079	12,602	18,347	12,514	5,833	7,334	565	6,769
20,000 - 29,999	32,173	14,042	18,131	17,581	13,663	3,918	14,592	379	14,213
30,000 - 39,999	33,135	12,301	20,834	16,480	11,899	4,581	16,655	402	16,253
40,000 - 49,999	29,333	8,005	21,328	11,511	7,716	3,795	17,822	289	17,533
50,000 - 99,999	191,659	12,776	178,883	24,484	12,303	12,181	167,175	473	166,702
100,000 - 249,999	134,481	5,096	129,385	11,773	4,918	6,855	122,708	178	122,530
\$250,000 - 499,999	52,103	1,063	51,040	4,951	1,032	3,919	47,152	31	47,121
> \$500,000	102,585	599	101,986	18,165	552	17,613	84,420	47	84,373
Total	\$603,760	\$67,883	\$535,877	\$124,446	\$65,494	\$58,952	\$479,314	\$2,389	\$476,925

FAGI	Gap Returns	Nonfiler Returns	Underreporting Returns
< \$4,999	161,464	138,185	23,279
\$5,000 - 9,999	48,508	27,488	21,020
10,000 - 19,999	117,471	78,188	39,283
20,000 - 29,999	68,593	29,331	39,262
30,000 - 39,999	57,583	16,828	40,756
40,000 - 49,999	42,278	8,814	33,464
50,000 - 99,999	119,429	11,494	107,935
100,000 - 249,999	44,657	2,630	42,028
\$250,000 - 499,999	6,600	436	6,163
> \$500,000	3,048	263	2,785
Total	669,631	313,655	355,975

Minnesota Individual Income Tax Gap Total Rates of Noncompliance Tax Year 1999

FAGI	Tax Gap			Nonfilers			Underreporting		
	Total	Wage	Nonwage	Total	Wage	Nonwage	Total	Wage	Nonwage
< \$4,999	10.5%	0.1%	10.3%	1.4%	0.1%	1.3%	9.1%	0.0%	9.1%
\$5,000 - 9,999	10.5%	4.4%	6.1%	5.3%	4.3%	1.0%	5.2%	0.1%	5.1%
10,000 - 19,999	19.2%	9.8%	9.4%	13.7%	9.4%	4.4%	5.5%	0.4%	5.1%
20,000 - 29,999	12.0%	5.2%	6.8%	6.6%	5.1%	1.5%	5.4%	0.1%	5.3%
30,000 - 39,999	9.1%	3.4%	5.7%	4.5%	3.3%	1.3%	4.6%	0.1%	4.5%
40,000 - 49,999	8.1%	2.2%	5.9%	3.2%	2.1%	1.0%	4.9%	0.1%	4.8%
50,000 - 99,999	10.5%	0.7%	9.8%	1.3%	0.7%	0.7%	9.2%	0.0%	9.1%
100,000 - 249,999	10.5%	0.4%	10.1%	0.9%	0.4%	0.5%	9.6%	0.0%	9.6%
\$250,000 - 499,999	10.5%	0.2%	10.3%	1.0%	0.2%	0.8%	9.5%	0.0%	9.5%
> \$500,000	10.5%	0.1%	10.4%	1.9%	0.1%	1.8%	8.6%	0.0%	8.6%
Total	10.5%	1.2%	9.3%	2.2%	1.1%	1.0%	8.4%	0.0%	8.3%

**Minnesota Individual Income Tax Liability
Tax Year 1999**

FAGI	Tax on Total Income (\$000)	Tax on Filer Income		Tax on Nonfiler Income (\$000)
		Voluntary (\$000)	Underreported (\$000)	
< \$4,999	\$4,019	\$3,597	\$365	\$57
\$5,000 - 9,999	20,830	18,642	1,091	1,097
10,000 - 19,999	134,185	108,504	7,334	18,347
20,000 - 29,999	268,570	236,397	14,592	17,581
30,000 - 39,999	365,095	331,960	16,655	16,480
40,000 - 49,999	364,058	334,725	17,822	11,511
50,000 - 99,999	1,825,160	1,633,501	167,175	24,484
100,000 - 249,999	1,280,661	1,146,180	122,708	11,773
\$250,000 - 499,999	496,172	444,069	47,152	4,951
> \$500,000	976,909	874,324	84,420	18,165
Total	\$5,735,659	\$5,131,899	\$479,314	\$124,446

FAGI	Number of Returns, All Income	Number of Returns, Filer Income		Number of Returns, Nonfilers
		Voluntary	Underreported	
< \$4,999	380,297	242,112	23,279	138,185
\$5,000 - 9,999	237,082	209,594	21,020	27,488
10,000 - 19,999	441,348	363,160	39,283	78,188
20,000 - 29,999	337,718	308,387	39,262	29,331
30,000 - 39,999	268,412	251,584	40,756	16,828
40,000 - 49,999	195,500	186,686	33,464	8,814
50,000 - 99,999	533,404	521,910	107,935	11,494
100,000 - 249,999	148,116	145,486	42,028	2,630
\$250,000 - 499,999	19,738	19,302	6,163	436
> \$500,000	9,166	8,903	2,785	263
Total	2,570,779	2,257,124	355,975	313,655

FAGI	Mean Tax Per Return (\$)	Mean Tax per Filer		Mean Tax per Nonfiler (\$)
		Voluntary (\$)	Underreported (\$)	
< \$4,999	\$11	\$15	\$16	\$0
\$5,000 - 9,999	88	89	52	40
10,000 - 19,999	304	299	187	235
20,000 - 29,999	795	767	372	599
30,000 - 39,999	1,360	1,319	409	979
40,000 - 49,999	1,862	1,793	533	1,306
50,000 - 99,999	3,422	3,130	1,549	2,130
100,000 - 249,999	8,646	7,878	2,920	4,477
\$250,000 - 499,999	25,138	23,006	7,650	11,350
> \$500,000	106,581	98,206	30,312	69,094
Total	\$2,231	\$2,274	\$1,346	\$397

**Minnesota Individual Income Tax Liability
Wage Income, Tax Year 1999**

FAGI	Tax on Total Wage Income (\$000)	Tax on Filer Wage Income		Tax on Nonfiler Wage Income (\$000)
		Voluntary (\$000)	Underreported (\$000)	
< \$4,999	\$3,126	\$3,120	\$0	\$6
\$5,000 - 9,999	15,897	14,981	25	891
10,000 - 19,999	96,729	83,650	565	12,514
20,000 - 29,999	198,254	184,212	379	13,663
30,000 - 39,999	284,586	272,285	402	11,899
40,000 - 49,999	278,354	270,349	289	7,716
50,000 - 99,999	1,325,344	1,312,568	473	12,303
100,000 - 249,999	815,386	810,290	178	4,918
\$250,000 - 499,999	242,273	241,210	31	1,032
> \$500,000	242,095	241,496	47	552
Total	\$3,502,044	\$3,434,161	\$2,389	\$65,494

FAGI	Number of Returns, Wage Income	Number of Returns, Filer Wage Income		Number of Returns, Wage Nonfilers
		Voluntary	Underreported	
< \$4,999	326,641	189,481	4,358	137,160
\$5,000 - 9,999	198,783	177,766	4,089	21,017
10,000 - 19,999	330,759	291,195	6,697	39,564
20,000 - 29,999	282,306	265,458	6,106	16,848
30,000 - 39,999	232,447	223,447	5,139	9,000
40,000 - 49,999	173,732	169,354	3,895	4,378
50,000 - 99,999	490,100	485,074	11,157	5,026
100,000 - 249,999	134,328	133,384	3,068	944
\$250,000 - 499,999	16,795	16,664	383	131
> \$500,000	7,742	7,676	177	66
Total	2,193,631	1,959,499	45,068	234,132

FAGI	Mean Wage Tax Per Return (\$)	Mean Wage Tax per Filer		Mean Wage Tax per Nonfiler (\$)
		Voluntary (\$)	Underreported (\$)	
< \$4,999	\$10	\$16	\$0	\$0
\$5,000 - 9,999	80	84	6	42
10,000 - 19,999	292	287	84	316
20,000 - 29,999	702	694	62	811
30,000 - 39,999	1,224	1,219	78	1,322
40,000 - 49,999	1,602	1,596	74	1,762
50,000 - 99,999	2,704	2,706	42	2,448
100,000 - 249,999	6,070	6,075	58	5,211
\$250,000 - 499,999	14,426	14,475	81	7,893
> \$500,000	31,270	31,461	266	8,364
Total	\$1,596	\$1,753	\$53	\$280

**Minnesota Individual Income Tax Liability
Nonwage Income, Tax Year 1999**

FAGI	Tax on Total Nonwage Income (\$000)	Tax on Filer Nonwage Income		Tax on Nonfiler Nonwage Income (\$000)
		Voluntary (\$000)	Underreported (\$000)	
< \$4,999	\$893	\$477	\$365	\$51
\$5,000 - 9,999	4,933	3,661	1,066	206
10,000 - 19,999	37,456	24,854	6,769	5,833
20,000 - 29,999	70,316	52,185	14,213	3,918
30,000 - 39,999	80,509	59,675	16,253	4,581
40,000 - 49,999	85,704	64,376	17,533	3,795
50,000 - 99,999	499,816	320,933	166,702	12,181
100,000 - 249,999	465,275	335,890	122,530	6,855
\$250,000 - 499,999	253,899	202,859	47,121	3,919
> \$500,000	734,814	632,828	84,373	17,613
Total	\$2,233,615	\$1,697,738	\$476,925	\$58,952

FAGI	Number of Returns, Nonwage Income	Number of Returns, Filer Nonwage Income		Number of Returns, Nonwage Nonfilers
		Voluntary	Underreported	
< \$4,999	138,254	136,846	18,921	1,408
\$5,000 - 9,999	123,856	116,333	16,931	7,523
10,000 - 19,999	251,114	210,750	32,586	40,364
20,000 - 29,999	220,199	201,217	33,157	18,982
30,000 - 39,999	205,170	193,030	35,617	12,140
40,000 - 49,999	168,856	162,065	29,569	6,791
50,000 - 99,999	511,220	501,713	96,778	9,507
100,000 - 249,999	146,800	144,485	38,960	2,315
\$250,000 - 499,999	19,698	19,302	5,780	396
> \$500,000	9,160	8,903	2,609	257
Total	1,794,327	1,694,644	310,907	99,683

FAGI	Mean Nonwage Tax Per Return (\$)	Mean Nonwage Tax per Filer		Mean Nonwage Tax per Nonfiler (\$)
		Voluntary (\$)	Underreported (\$)	
< \$4,999	\$6	\$3	\$19	\$36
\$5,000 - 9,999	40	31	63	27
10,000 - 19,999	149	118	208	145
20,000 - 29,999	319	259	429	206
30,000 - 39,999	392	309	456	377
40,000 - 49,999	508	397	593	559
50,000 - 99,999	978	640	1,723	1,281
100,000 - 249,999	3,169	2,325	3,145	2,961
\$250,000 - 499,999	12,889	10,510	8,152	9,885
> \$500,000	80,221	71,080	32,345	68,559
Total	\$1,245	\$1,002	\$1,534	\$591

Methodology

Summary of Approach

We compute the total income tax that would have been generated in Minnesota if everyone who should have filed did so, and if all filers reported the correct tax liability. This overall tax liability is calculated using data from the 2000 census and from the 1999 income tax sample (described in the following section). From that figure, we subtract the amount actually paid on a voluntary basis. What remains is the income tax gap. The gap consists of two parts: that attributable to nonfiling, and that attributable to underreporting. The portion attributable to nonfiling is estimated from various data sources described later. The portion attributable to underreporting is the remainder after the nonfiler tax gap is subtracted from the total income tax gap.

We divided the tax liability into two parts: that attributable to wage income and that attributable to all other income. This was done for all components of the analysis: the expected tax liability, assuming full compliance; the income tax actually received; the amounts due from nonfilers; and the amounts due from underreporters. Where both wage and nonwage income figures were available, they were used to determine the fractional share of tax allocated to each. For the W-2 file (discussed below), we assumed that all income is wage income.

There are also persons for whom no tax administrative information at all is available, but that the census data indicates should have filed. These “invisibles” are discussed below. For such persons, the assumption is that all income is nonwage.

Underreported wage income was assumed to be 0.5 percent of all underreported income, based on the most current information available.

Census data allows an estimate of the total number of filers assuming full compliance. Of course, we also have the total number of those who did actually file. The number of nonfilers was estimated from various data sources described later. The number of underreporters is based on IRS Taxpayer Compliance Measurement Program data.

Data

The study used four sources of data.

2000 Census. Detailed information about Minnesotans is available from the 2000 United States census. This study used the 1 percent Public Use Microdata Sample (PUMS), a random sample of 1 percent of Minnesota households (with personal identifying information removed). The PUMS sample contains information on all individuals in a given household. This includes age, family structure, relationship to the head of household, income by type, educational status and many other variables. From this, it is possible to derive an estimate of the number of income tax returns that should have been filed by the individuals in each of the sample households, and hence the number that

should have been filed by all Minnesota residents. It is also possible to distribute those returns by income level.

Census income categories are more aggregated, and thus less specific, than tax income categories. The census collects information on six kinds of income that are taxable in whole or in part: wages and salary; self-employment (including farming); unearned income, including interest, dividends and rents; social security; retirement other than social security; and a miscellaneous category that includes taxable items such as unemployment compensation and nontaxable income such as child support. The census also collects information on two wholly nontaxable income categories: supplemental security income (SSI) and public assistance.

Income Types for Gap Estimates

<u>Census Categories</u>	<u>Form 1040</u>
➤ Wage and salary	Wage and salary
➤ Self-employment income	Business income Farm income
➤ Interest, dividends, net rental income, royalties, income from trusts and estates	Taxable interest Tax-exempt interest Dividends Schedule E income
➤ Social security retirement	Social security
➤ Supplemental security (SSI)	Not taxable
➤ Public assistance	Not taxable
➤ Pensions (other than social security)	IRA distributions Pensions Workers Comp. (nontaxable)
➤ Other (e.g., VA payments, unemployment, child support, alimony) if received periodically	Alimony Unemployment Other income Nontaxable Income
Census does not capture episodic or one-time income such as capital gains.	Capital gains Other gains

Census income information is not sufficient to allow direct calculation of income tax liability for each return for three reasons:

1. The census definition of income includes only items received periodically, such as wages and interest. It omits income received episodically, such as capital gains.
2. Census income is aggregated into eight categories. While for some of these categories all the income is either taxable or not taxable, for others the two are mixed and it is difficult to separate the two. For example, the census category that includes interest includes both taxable and nontaxable interest.
3. Income amounts are topcoded to prevent individuals from being identified in the sample; that is, incomes that exceed a threshold amount (which depends on the particular type of income) are listed as equal to the threshold. Therefore it is not possible to use census data to replicate tax returns for high-income persons.

1999 income tax sample. A second source of information is a sample of resident income tax returns filed with the Minnesota Department of Revenue for tax year 1999. This database includes detailed information about income types, filing status and tax liability.

Various IRS data sets. A third source is information concerning those who did not file a Minnesota tax return for 1999. The data falls into two groups, each with two subsets.

The first group of records consists of those who filed a 1999 federal tax return. This group was divided into those with taxable incomes less than \$5,000 and those with taxable income greater than that amount, which corresponds to the way tax compliance efforts are organized. The department focuses its tax compliance programs on those with taxable incomes greater than \$5,000.

The second group consists of those who did not file a federal return but for whom income data was available from payer information supplied to the IRS (such as wages reported by employers or interest reported by financial institutions). These federal nonfilers were further divided into those with gross income between \$10,000 and \$20,000, and those with gross income greater than \$20,000. This division corresponds to the department's compliance efforts. For those with gross income greater than \$20,000, additional information had often been developed. It was assumed that those with gross income below \$10,000 were unlikely to be required to file, so no effort was made to analyze those cases.

Counts of underreporters, and distribution by income level, were based on 1988 data from the Taxpayer Compliance Measurement Program of the Internal Revenue Service.

W-2 data. The final source is wages paid and amounts withheld as reported by employers directly to the Minnesota Department of Revenue. This is not a complete data set; it includes only those employers who report information electronically. Of the records in the W-2 file, most had sufficient information to make it possible to determine which individuals had filed an income tax return or which had not. (Some records had personal identifiers that were either missing or incomplete, and these could not be

assigned to either category.) To estimate how many nonfilers were missing from the electronic W-2 data, the number of W-2 records in this file identified as filers was compared to the number of W-2s in the income tax sample (blown up to represent the entire population of filers). For 1999, we estimate that employers reported about 52 percent of W-2s for filers electronically. This same percentage was applied to W-2s for nonfilers, and the number of nonfilers obtained from the W-2 file was scaled up proportionately.

While the W-2 file is a source of nonfiler information, it must be noted that taxes have for the most part been withheld from the associated wages. Many of these individuals might have been due refunds had they filed. Some may owe taxes, also. Therefore, the potentially recoverable income tax gap is less than the total gap discussed in the analysis.

Computations

To create an estimate of the total income tax liability for Minnesota residents, the income tax sample was modified to resemble the census income data as much as possible. Income tax sample incomes were topcoded in the same manner as census incomes, and capital gains were dropped. The ratio of census total income to the adjusted income tax sample total income was calculated, and that ratio was used to scale up the tax liability for each income interval in the income tax sample. The result is an estimate of what the tax liability would be (for each income range) if everyone in the census who was required to do so had filed and paid the correct tax.

This approach assumes that when people fill out the income portion of their census forms they use tax concepts of income. Also implicit is the assumption that income types not asked about in the census and therefore unobserved for census respondents (capital gains, for example) are similar in magnitude and distribution to those of the sample returns.

The amount actually paid voluntarily, of course, comes from the income tax sample (which accurately reflects the filer population). The difference between the two, at each income range level, defines the total income tax gap.

Calculation of tax owed by nonfilers came from analyzing the IRS and W-2 data sets. For nonfilers who had filed federal tax returns, Minnesota taxable income, and then Minnesota tax liability, was calculated. For those who had not filed a federal return and for whom additional information had not been generated through the compliance process, we made assumptions that were sufficient to allow a tax liability to be calculated. These assumptions were the same as those made in creating a commissioner-filed return: the filer is single, with one personal exemption, and claims the standard deduction.

The invisibles. The census data provided an estimate of the total number of taxpayers who should have filed. After subtracting those who did file and the nonfilers who could be identified from other data sources, we were left with a shortfall of about 34,000 returns that were not filed and for which no income or tax data exist. These are the invisibles. Since they did not appear on the W-2 file, we assumed that all income for the invisibles is nonwage income.

Tax gap and other data presented in this study are divided into two parts: that attributable to wage income and that attributable to all other income. Where sufficient data exists, the fraction allocated to each is determined by the relative magnitude of each kind of income. In other cases, only one kind of income is known, and there (as in the case of nonfilers from the W-2 file) the entire tax amount is allocated to that type of income.

Evaluating the Results

As is apparent from the discussion in this report, measuring the tax gap is difficult. Yet a comparison of the gap amount in this report to a gap value derived differently implies some degree of confidence in the results given here.

A comparison of national income amounts by type between values computed by the Bureau of Economic Analysis and aggregate Internal Revenue Service incomes by type shows a national income shortfall – gap – of roughly \$707 billion for 1999. If Minnesota accounts for 2 percent of this total then there is an income gap here of \$14 billion. By comparison our estimated tax gap of \$604 million implies an income gap here of perhaps \$11 billion, assuming an average tax rate of 5.5 percent.

Narrowing the Gap

The most recent estimate of Minnesota's individual income tax gap, for fiscal year 1990, was \$457 million, compared to the estimate for 1999 of \$604 million, a difference of \$147 million. This does not mean that the gap has grown by that amount, however. The gap amounts are not exactly comparable, for several reasons. The previous study used a methodology quite different from that employed here. In the earlier report, the tax gap was estimated by assuming that nonfiler and underreporting percentages were the same in Minnesota as for federal income taxes. Federal data were available from the IRS Taxpayer Compliance Measurement Program (TCMP) for tax year 1987. The individual income tax gap at the federal level was 15.9 percent of individual tax receipts, and that percentage was applied to Minnesota collections data as reported by the Bureau of the Census. This approach would not have been desirable for the present study because the TCMP program ended in 1987.

As a result of the difference in methodology, the 1999 figure in this report is the gap before income tax credits, while the 1990 figure is after credits. The 1990 figure incorporates only "known" nonfilers (based on audit information), while the 1999 figure includes the universe of nonfilers.

Finally, during the intervening years the economy has grown considerably, while income tax rates were reduced significantly, both of which would act to reduce the average gap per dollar of state income.

Improving compliance. Tax administrators try various methods to bring about increased tax compliance. They include both carrot and stick approaches: increasing audit rates, increasing penalties for noncompliance, increasing administrative contact between tax agencies and taxpayers, making collections procedures or agencies more visible, offering tax amnesty programs, offering taxpayer education sessions, and making tax policy changes.

During the last four years, the Minnesota Department of Revenue has done the following to promote income tax compliance:

- Added 34 field audit positions through Legislative initiatives.
 - ◆ Grew from 19 to 53 since 2000.
 - ◆ Audit assessments grew from \$19 million in FY 03 to \$40 million in FY 04.
- Expanded our computerized IRS data matching programs.
 - ◆ More than 30,000 computer-generated deficiency notices will be generated by the end of August.
- Redirected 12 telephone assistance positions to office audits.
- Greatly expanded our “early audit” and fraud detection programs.
 - ◆ Reviewed more than 14,000 returns this year before releasing any refunds.
 - ◆ Reduced refunds by \$42.7 million in calendar years 2002 and 2003.
- Greatly expanded our nonfiler discovery program through automation.
 - ◆ Quintupled the case resolutions with half the staff.
 - ◆ Since October 2000, more than 47,000 nonfiler cases have been resolved, \$160 million assessed, and more than \$40 million collected.
 - ◆ More than 50 percent of the resolved taxpayers remain in compliance.
- Added positions in the Collection Division to collect income taxes.
- Heightened public awareness through substantial media exposure of tax evasion charges, convictions or guilty pleas.

Looking forward, our plans for future compliance initiatives are to:

- Continue to expand our electronic fraud detection system.
- Continue to pursue fraudulent tax preparers both civilly and criminally.
- Expand our outreach and education programs for immigrant communities.
- Consider the impact of statewide licensing of tax preparers.
- Use technology in discovery operations (business intelligence software, geographic information systems, and warehouse development).

Appendix: Nonfiler Detailed Tables

**Minnesota Individual Income Tax Gap
Tax Year 1999
(\$1,000s)**

Federal Return: Taxable Income < \$5,000				
Income Range	Tax Liability	Wage	Nonwage	Count
< \$4,999	\$2,528	\$416	\$1,561	619
\$5,000 - 9,999	351,732	234,004	70,891	3,979
10,000 - 19,999	526,123	289,884	146,854	4,516
20,000 - 29,999	47,845	24,863	13,880	492
30,000 - 39,999	6,810	1,864	3,202	110
40,000 - 49,999	745	119	343	37
50,000 - 99,999	1,297	285	694	39
100,000 - 249,999	125	12	96	7
\$250,000 - 499,999	0	0	0	-
> \$500,000	0	0	0	1
Total	\$937,205	\$551,446	\$237,521	9,800

Federal Return: Taxable Income > \$5,000				
Income Range	Tax Liability	Wage	Nonwage	Count
< \$4,999	\$24,585	\$24,585	\$0	7
\$5,000 - 9,999	20,886	14,798	5,605	76
10,000 - 19,999	444,142	343,809	76,043	1,340
20,000 - 29,999	842,411	632,733	151,494	1,550
30,000 - 39,999	858,616	656,131	150,300	961
40,000 - 49,999	783,000	569,906	154,575	705
50,000 - 99,999	2,184,797	1,122,539	913,036	1,256
100,000 - 249,999	1,185,595	752,032	336,778	341
\$250,000 - 499,999	220,427	151,005	65,556	46
> \$500,000	379,090	159,196	207,701	27
Total	\$6,943,549	\$4,426,734	\$2,061,087	6,309

Minnesota Individual Income Tax Gap
Tax Year 1999
(\$1,000s)

No Federal Return: Gross Income > \$20,000				
Income Range	Tax Liability	Wage	Nonwage	Count
< \$4,999	\$0	\$0	\$0	-
\$5,000 - 9,999	0	0	0	-
10,000 - 19,999	0	0	0	-
20,000 - 29,999	5,149,547	3,707,184	1,442,363	6,216
30,000 - 39,999	5,709,320	3,984,900	1,724,420	4,140
40,000 - 49,999	4,152,244	2,723,527	1,428,717	2,170
50,000 - 99,999	8,375,483	4,199,390	4,176,093	2,762
100,000 - 249,999	3,733,567	1,052,082	2,681,485	630
\$250,000 - 499,999	1,768,687	152,815	1,615,872	124
> \$500,000	7,503,147	224,684	7,278,464	81
Total	\$36,391,995	\$16,044,582	\$20,347,414	16,123

No Federal Return: Gross Income Between \$10,000 and \$20,000				
Income Range	Tax Liability	Wage	Nonwage	Count
< \$4,999	\$0	\$0	\$0	-
\$5,000 - 9,999	0	0	0	-
10,000 - 19,999	8,021,216	8,021,216	0	20,700
20,000 - 29,999	0	0	0	-
30,000 - 39,999	0	0	0	-
40,000 - 49,999	0	0	0	-
50,000 - 99,999	0	0	0	-
100,000 - 249,999	0	0	0	-
\$250,000 - 499,999	0	0	0	-
> \$500,000	0	0	0	-
Total	\$8,021,216	\$8,021,216	\$0	20,700

Minnesota Individual Income Tax Gap
Tax Year 1999
(\$1,000s)

W-2 File				
Income Range	Tax Liability	Wage	Nonwage	Count
< \$4,999	\$0	\$0	\$0	136,680
\$5,000 - 9,999	604	604	0	17,742
10,000 - 19,999	5,951	5,951	0	14,374
20,000 - 29,999	9,254	9,254	0	9,499
30,000 - 39,999	7,231	7,231	0	4,312
40,000 - 49,999	4,360	4,360	0	1,813
50,000 - 99,999	6,811	6,811	0	1,746
100,000 - 249,999	2,852	2,852	0	281
\$250,000 - 499,999	674	674	0	27
> \$500,000	0	0	0	0
Total	\$37,736	\$37,736	\$0	186,472

Invisibles				
Income Range	Tax Liability	Wage	Nonwage	Count
< \$4,999	\$30	\$0	\$30	878
\$5,000 - 9,999	120	0	120	5,688
10,000 - 19,999	3,405	0	3,405	37,252
20,000 - 29,999	2,288	0	2,288	11,584
30,000 - 39,999	2,675	0	2,675	7,310
40,000 - 49,999	2,216	0	2,216	4,085
50,000 - 99,999	7,112	0	7,112	5,691
100,000 - 249,999	4,002	0	4,002	1,372
\$250,000 - 499,999	2,288	0	2,288	238
> \$500,000	10,283	0	10,283	153
Total	\$34,418	\$0	\$34,418	74,251

Glossary

census – the decennial collection of information of various kinds on Americans; as used in this study, refers to information about Minnesotans.

commissioner-filed return – a return prepared by the Minnesota Department of Revenue for a nonfiler, based on information available to the department. Usually this comprises one or more income amounts. A set of assumptions necessary to complete a return is used: the taxpayer is single, has one personal exemption, and uses the standard deduction.

filers – those who file a return.

income tax sample – a stratified random sample of Minnesota tax returns collected and prepared by the Minnesota Department of Revenue.

invisibles – nonfilers for whom no data sources such as W-2s or federal information exist.

nonfilers – those who are liable for tax but do not file a return or pay tax, or people who need to file to claim a refund.

nonwage income – all income other than wage income. Includes, for example, net income from a business (sole proprietorship), interest on a bank account, or income from rental property.

PUMS – acronym for Public Use Microdata Sample; a 1 percent or 5 percent sample of census information about Minnesotans (with personal identifying information removed).

tax compliance – behavior that results in the correct amount of tax being reported and paid.

tax gap – the difference between what revenue would be collected from a tax if everyone paid the correct amount, and what is actually collected. Does not include illegal activity except to the extent it is reported on a tax return, or is included in response to census questions concerning income.

topcode – a technique to prevent individuals from being identified in a sample; values in excess of a specified amount for a particular variable are reported as equal to that amount.

underreporters – those who file a return but report and pay less tax than is due.

voluntary tax – a tax amount correctly calculated and reported on a return filed at the initiative of the taxpayer.

W-2 – IRS form on which wage income is reported.

wage income – income from wages and salaries.