The LG Tax System for Federal Individual Income Tax Compliance

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Abstract: Tax evasion costs the IRS and state governments billions of dollars each year. The proposed LG tax system is used to reduce or prevent potential evasion and tax fraud by employees against governments via tax withholding reports. The IRS and many state governments have two tax systems for employers and individuals. The different systems would bring about employers and individuals to have diverse standards or references to the similar tax rates. On another occasion, before sending out tax refunds from the IRS and state governments, the detailed tax information was unclear and not determined. The W-2 form provides only limited information on processing individual returns. This paper explores these two major loopholes and provides proposed tax withholding reports with the LG tax system to replace the W-2 form for reducing some potential tax noncompliance issues. The significant costs would then be saved for both individuals and governments.

Key words: tax compliance; individual income tax; linear and gradual tax system

JEL codes: G18, H21, H25, H71, C02

1. Introduction and Literature Review

Tax evasion is the practice of tax fraud or noncompliance with tax laws wherein the taxpayer makes a deliberate attempt to misrepresent personal or entity taxable income to the Internal Revenue Service (IRS) and state governments. Some tax evasion is caused by mistakes by employees and governments. Tax evasion can take several fraudulent forms, including taxpayers trying to under-pay or to avoid paying taxes, underreport or hide their income, overstate expenses or deductions, use accounting indiscretions, or omit or transfer income or assets illegitimately. These types of tax evasion are intentional tax liabilities concealed from the government, resulting in people not paying taxes. The consequence of tax noncompliance is subject to substantial penalties and criminal punishment.

The Tax Relief and Health Care Act of 2006 (Pub. L. 109-432, 120 Stat. 2922) is a federal statute that expanded the rights of individuals who provided the IRS with information about tax law violations. Under Section 7201 of the Internal Revenue Code, tax evasion is punishable with a fine of up to $100,000 for an individual or $500,000 if the taxpayer is a corporation, imprisonment of up to five years, or both. The IRS has created incentives to encourage disclosures from individuals who are aware of significant incidents of tax fraud.

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In the IRS report, the underreporting of income remained the biggest contributing factor to the tax gap across taxpayer categories, accounting for an estimated $376 billion of the gross tax gap in 2006. It increased more than 30% from $285 billion in 2001. Tax non-filing was reported at $28 billion in 2006, up from $27 billion in 2001. The underpayment of tax increased to $46 billion from $33 billion in the previous study. In general, the highest compliance is achieved if third-party information reporting and/or withholding is involved. The study also shows that the most wages and salaries are reported by employers to the IRS on W-2 forms and are subject to withholding. Consequently, only a net of 1 percent of wage and salary income was misreported. However, the amounts had a 56 percent net misreporting rate that is subject to little or no information reporting in 2006. In other words, 18 to 19 percent of total income was not properly reported to the IRS.

A James and Alley (2004) study described some important factors that may affect the willingness of taxpayers to comply with the tax system. Two economic and behavioral approaches to tax compliance were analyzed. Caution should be observed in the use of penalties in tax non-compliance cases. They emphasized assisting citizens in meeting their tax obligations and they encouraged voluntary compliance as well as deterring willful non-compliance. They suggested that a successful strategy for tax compliance should be implemented that is based on all relevant factors and their interactions.

Hyman (2014) completed tax compliance study on income taxes. He suggested some effective ways to decrease tax evasion, including increasing both the probability of IRS tax audits for taxpayers and the requirements for reporting income to the IRS as well as withholding taxes from earnings. However, in the beginning of 1963 and continuing every three years until 1988, the IRS randomly selected 45,000 to 55,000 households for a detailed audit as part of the Taxpayer Compliance Measurement Program (TCMP). The intention was to measure the unreported income and to analyze the "tax gap" (Andreoni, Erard, & Feinstein, 1998). The program was discontinued, partly because of intrusiveness, but the estimates continued to be used as assumptions. In 2001, a modified National Research Program was used to randomly sample 46,000 individual taxpayers. The IRS then released the updated estimates of the tax gap in 2005 and 2006 (Slemrod, 2007).

Some critics have been questioned on measuring the tax gap criteria. The indirect measurement methods of currency ratio models are commonly used by the IRS direct audit for noncompliance measurement (Feige, 1989). The Internal Revenue Service (2012) released a new set of tax gap estimates for the year 2006. The voluntary compliance rate or the percentage of total tax revenue paid on a timely basis was estimated to be 83.1 percent. Hence, the voluntary compliance rate for 2006 is statistically unchanged from the prior estimate of 83.7 percent measured for tax year 2001.

Also, the current filing deadlines do not allow the IRS and taxpayers to access third-party information for tax preparation. Taxpayers' filing data for tax filing status, deductions, exemption number, taxable income, tax rates, and taxes paid, which are not covered by W-2 forms, are known after the IRS receives their tax returns by April 15. Before receiving tax returns, the IRS has no detailed individual tax data as references ready for comparison. As a result, the current tax systems limit taxpayers' information for filing accurate and timely returns. Then, the IRS does not have enough time to verify the taxpayers' returns before sending refunds to taxpayers, which gives criminals a chance at tax evasion; such fraud costed the IRS some $5.2 billion in 2013 (Shipley, 2015).

Kao and Lee (2013) developed a linear and gradual (LG) tax system to simplify current U.S. individual income taxation in 2011 and 2012. These studies tried to reduce the current complex Tax Tables and Tax Rate Schedules without tax estimation via the accurate tax rate and tax calculations. They (2014) further developed the LG tax system to simplify current U.S. federal and state corporate income taxation in 2012 and 2013 from eight

federal corporate tax brackets to four. The suggested tax system also can simplify current state individual income systems practically. Several advantages of the LG tax system include the simplified tax/tax rate calculations, analysis, and forecasts with less tax processing time and lower management costs for individuals, corporations, and governments.

This research paper is based on the LG tax system and simplifies the federal individual and corporate tax systems for 2013, 2014, and 2015. The proposed LG tax system combines the existing complex Tax Rate Schedules, the Tax Table (12 pages) and Tax Computations together for employers and employees, and it provides computer programs to calculate tax rates and taxes to be paid automatically. Employers may let the IRS access tax withholding reports with taxpayers' detailed information such as name, Social Security number, filing status, exemption number, retirement, deductions, credit, Social Security tax, Medicare tax, gross income, taxable income, tax rate, and taxes paid, all of which could be used for detailed comparison and verification by January 15 from employers for accurate tax information. Also, tax withholding reports may provide the possibility for taxpayers with one income source to pay exact taxes from withholding taxes, and have the option to file exemptions for their tax returns. Many taxpayers with low tax differences (such as < $1,000) may use tax withholding reports with or without minor modifications to replace their tax returns. The LG tax simplification simplifies tax rate/tax calculations, analysis, modifications, reforms, and projections for tax administration without changing existing tax rates, which may be performed by the IRS. The LG tax system simplifies tax rates effectively according to actual situations for tax legislation.

2. Implications

Tax evasion costs billions of dollars to federal and state governments and taxpayers annually for three major reasons. One is that the IRS and many state governments have two tax systems, one for employers to estimate withholding income taxes, and another for individuals to calculate accurate taxes on tax returns. The two tax systems are not connected each other. Employers and individuals have different standards or references, and even the two tax systems have similar tax rates. Employers report on W-2 forms, which do not include detailed tax information such as tax filing status, exemptions, deductions, and taxable income, to the IRS by March 15. Another reason relates to the timing problem. When receiving tax returns from individuals, the IRS and state governments have no detailed tax information as a reference to compare and verify these tax returns and send tax refunds within 45 or even 15 days. These two major reasons give delinquents a chance at possible tax evasion. The third reason is that some people engage in tax fraud purposely, which required legal action. A partial third reason may be prevented by verifying or further inspecting tax withholding reports and tax returns. The first two problems may be overcome by the proposed LG tax system. The above two tax systems can be simplified and combined. Also, the IRS and state governments can receive detailed tax information from employers by January 15 or February 15 with modifications. Before receiving tax returns, the IRS and state governments have detail individual tax information as references to make comparisons and conduct verifications. Thus, tax evasion could be reduced or avoided for individuals and governments.

2.1 Reasons to Cause Potential Tax Evasion in the Existing Tax Systems

2.1.1 The Existing Two Tax Systems Used by Employers and Individuals

In our existing federal tax system for individuals, there are seven tax brackets with 10%, 15%, 25%, 28%, 33%, 35% and 39.6% with tax rates at 10%-39.3% for the four filing statuses: (1) Married Filing Jointly or

Qualifying Widow(er); (2) Head of Household; (3) Single; and (4) Married Filing Separately.

Table 1   Federal Individual Tax Rate Schedules (2014 and 2015) for Tax Estimation (Partial)

Taxable income (TI) Over Not over	2014 Tax	Of the amount over	Taxable income (TI) Over Not over	2015 Tax	Of the amount over
Schedule Y 1 — Married Filing Jointly or Qualifying Widow(er)					
$0-18,150	10%		$0-18,450	10%	
$18,150-73,800	$1,815 + 15%	$18,150	$18,450-74,900	$1,845 + 15%	$18,150
$73,800-148,850	$10,162.50 + 25%	$73,800	$74,900-151,200	$10,312.5 + 25%	$74,900
$148,850-226,850	$28,925 + 28%	$48,850	$151,200-230,450	$29,387.5+28%	$151,200
$226,850-405,100	$50,765 + 33%	$226,850	$230,450-411,500	$51,577.5 + 33%	$230,450
$405,100-457,600	$109,587.5 + 35%	$405,100	$411,500-464,850	$111,324 + 35%	$411,500
$457,600	$127,962.5+39.6%	$457,600	$464,850	$129,996.5+39.6%	$464,850

Table 2   Federal Tax Table for Married Filing Jointly or Qualifying Widow(er) (12 pages)

Taxable income (TI)	Tax	Taxable Income (TI)	Tax	Taxable Income (TI)	Tax
$0-5	$0	$10,000-10,050	$1,003		
		$10,050-10,100	$1,008	$75,900-75,950	$10,041
$2,000-2,050	$201			$75,950-76,000	$10,054
$2,050-2,100	$204	$30,000-30,050	$3,634		
		$30,050-30,100	$3,641	$99,950-100,000	$17,054

The IRS and many state governments have two tax systems. One is used for employers to estimate withholding income taxes with Tax Rate Schedules and related withholding tables; these may have 21+ pages. The Tax Rate Schedules for Married Filing Jointly (2014 and 2015) are shown in Table 1, which are used for employers to estimate withholding income taxes for employees. The Tax Rate Schedules in 2014 are modified slightly compared with the Tax Rate Schedules in 2015. The first tax rate is at 10% for taxable incomes from 0 to $18,150 in 2014 or from $0 to $18,450 in 2015 with a difference of $300 ($18,450-$18,150).

Another tax system that includes Tax Tables and Tax Computation is used for individuals to calculate accurate taxes on tax returns. Table 2 is the federal Tax Table and is used for individuals (such as Married Filing Jointly) who have a taxable income lower than $100,000 to search for and find information on their tax payments. These tax payments in the 12-page Tax Table have no direct connection to each other. The tax numbers in the Tax Table can be programmed with tax software with more data space and a complex search function, which is used for automatic searches. Table 3 shows Tax Computations in 2014, which has slight modifications compared with 2013. For taxable incomes of less than $450,000, the differences between the two years are minor. The Tax Table, Tax Computations and related taxable income ranges are modified every year such as from $146,400 to $148,850 and from 0.25 TI-8,142.5 to 0.25 TI-8, 287.5. The 2014 Tax Table and Tax Computations are slightly different from 2013. The 2015 Tax Table and Tax Computations are available from the IRS after January 2016. The Tax Schedules are used for estimating income taxes. Tax Table and Tax Computations are used for calculating accurate income taxes. However, The Tax Schedules and Tax Table/Tax Computations have no direct relationship.

The two different tax systems make employers use Tax Rate Schedules and individuals use Tax Tables and Tax Computations. There is no direct connection between the two tax systems, and even they have similar tax rates. Before receiving tax returns, the IRS has no detailed tax information on filing status, exemptions, deductions, retirement, credit, taxable income, tax rates, and taxes as references, and does not have information on these tax returns from real individuals because there is no reference for comparison; this may cause potential tax evasion.

Many states have similar two tax systems such as CA, IA, KS, MO, AR and HI. One tax system is for employers to estimate withholding income taxes. Another tax system is used for taxpayers to calculate accurate taxes. The two tax systems give potential criminals for possible tax frauds. State governments face the same challenge of tax evasions.

Table 3　Tax Computations for Married Filing Jointly or Qualifying Widow(er)

| Taxable Income (TI) | | 2014 Tax | Taxable Income (TI) | | 2013 Tax |
Over	Not over		Over	Not over	
$0	$100,000	Tax Table (12 pages)	0	$100,000	Tax Table (12 pages)
$100,000	$148,850	0.25×TI –8,287.5	$100,000	$146,400	0.25×TI – 8,142.5
$148,850	$226,850	0.28×TI –12,753	$146,400	$223,050	0.28×TI – 12,534.5
$226,850	$405,100	0.33×TI – 24,095.5	$223,050	$398,350	0.33×TI – 23,687
$405,100	$457,600	0.35×TI – 32,197.5	$398,350	$450,000	0.35×TI – 31,654
$457,600		0.396×TI–53,247	$450,000		0.396×TI –52,354

2.1.2 Tax Refunds, Timing, and Verification

After receiving tax returns, the IRS and state governments usually send out tax refunds within 45 or even 15 days. Most taxpayers send out their tax returns between March 1 and April 15. There is significant work for the IRS and the state governments to do specially for those tax returns, as they require tax refunds for their daily living costs. Employers report individual income information to governments on W-2 forms by March 15, which covers Social Security income, federal withholding income tax, and state withholding income tax. There is no detailed tax information such as filing status, exemptions, deductions, credits, taxable income, tax rates, and taxes paid from W-2 form.

Verification and timing are two key issues. When the IRS and state governments have no tax information on filing status, exemptions, deductions, credit, retirement, and taxable income before receiving tax returns, verification cannot be done by comparison before sending out tax refunds, which gives criminals a chance for possible tax evasion. Verification with comparison is needed before sending out tax refunds to reduce and avoid potential tax gaps that are especially for tax refunds in large amounts.

There are about 138 million federal taxpayers in the United States reportedly earning $9.03 trillion in AGI; they paid $1.23 trillion in income taxes in 2013. The top 50% of all taxpayers paid 97.2% of all income taxes, while the bottom 50 percent paid the remaining of 2.8% in 2012. All state tax return numbers may be somewhat lower than 138 million, as some states have no state income tax. The IRS and state governments are very busy in processing tax returns and tax refunds during the tax season. When employers transfer withholding income taxes for many employees who have non-complex tax situations, one-source incomes, and gross incomes less than $100,000/year to federal and state governments, these employees may have no or very small amounts of tax dues or tax refunds. The complication of the existing two federal tax systems with Tax Rate Schedules, Tax Tables, Tax Computations, changeable taxable income ranges and tax rates could then be simplified and improved to let many taxpayers have the option to not file tax returns; many taxpayers with low tax differences use tax withholding reports with or without minor modifications to replace their tax returns or delay them until next year. The processing time and operating cost could then be reduced significantly. Thus, the IRS and state governments can have more time to verify tax returns with high tax differences by comparison.

2.2 The Proposed LG Tax System for Reducing or Avoiding Tax Evasion

2.2.1 Combining and Simplifying the Existing Two Tax Systems into One System

Complex existing federal Tax Rate Schedules and Tax Tables/Tax Computations with changeable taxable income (TI) ranges can be combined together simply. The 2011 and 2012 tax systems have been discussed with a linear and gradual (LG) tax system by Kao and Lee (2013 and 2014b). Table 4 shows the LG tax system for 2014. The seven tax brackets in the existing two tax systems are reduced to four with a 43% reduction. The taxable income ranges are simplified into such as $0-100,000, $100,000-250,000, $250,000-450,000, and over $450,000. All Tax Schedules and Tax Tables/Tax Computations (33+ pages) can be replaced by Table 4 (half page).

When individuals (Married Filing Jointly or Qualifying Widow(er)), have taxable incomes from $0 to $100,000, a linear formula of $y = a + x/b$ is found to match tax rates from the Tax Rate Schedules and 12-page Tax Table. There is a check tool for tax rates within a narrow range of 10%-16.71%. Here, 1/1,490,313 is a constant with a slope of $y = a + x/b$. Tax rates change linearly over taxable incomes from $0 to $100,000. The bottom tax rate is 0.1 or 10% (a).

$$\text{Tax rate} = 0.1 + \text{TI}/1{,}490{,}313 \qquad (\text{tax rate range check: } 0.1\text{-}0.1671) \dots\dots\dots\dots\dots (1)$$

Example 1: When a person Married Filing Jointly has a taxable income of $39,855.26, the tax rate formula is 0.1+TI/1,490,313 (for 2014) with a range check (10%-16.71%). Then, 0.1+39,855.26/1,490,313 = 12.67% is the tax rate (the tax is $5,056.84). When the 2014 Tax Table (39,850-39,000) is used, the tax is $5,074 and the tax rate is at 12.72%. The tax rate difference is 0.05%, which is very minor. The item (39,850-39,000)/39,875 causes a tax rate difference of 0.13%.

Table 4   The LG Tax System for Federal Individual Tax Return (2014)

(1) Married Filing Jointly or Widow(er), (2) Head of Household, (3) Single, and (4) Married Filing Separately

Filing Status	Taxable Income (TI)		Your TI	LG tax rate formula	Tax rate	Range check	Your Tax
	Over	Not over					
1/1	$0	$100,000		0.1+TI×F/1,490,313		0.1-0.1671	
1/2	$100,000	$250,000		0.1228+TI×F/2,255,639		0.1671-0.2336	
1/3	$250,000	$450,000		0.3346-25,256.3/(TI×F)		0.2336-0.2785	
1/4	$450,000			0.396-52,875/(TI×F)		0.2785-0.396	
2/1	$0	$100,000		0.1+TI×F/1,062,699.3		0.1-0.1941	
2/2	$100,000	$250,000		0.1562+TI×F/2,636,203.9		0.1941-0.251	
2/3	$250,000	$450,000		0.3383-21,881.3/(TI×F)		0.251-0.2899	
2/4	$450,000			0.396-47,745/(TI×F)		0.2899-0.396	
3/1	$0	$75,000		0.1+TI×F/791,139.2		0.1-0.1948	
3/2	$75,000	$200,000		0.1621+TI×F/2,293,578		0.1948-0.2493	
3/3	$200,000	$400,000		0.3299-16,120/(TI×F)		0.2493-0.2896	
3/4	$400,000			0.396-42,560/(TI×F)		0.2896-0.396	
4/1	$0	$50,000		0.1+TI×F/745,156.5		0.1-0.1671	
4/2	$50,000	$125,000		0.1228+TI×F/1,127,819.5		0.1671-0.2336	
4/3	$125,000	$225,000		0.3346-12,628/(TI×F)		0.2336-0.2785	
4/4	$225,000			0.396-26,437.5/(TI×F)		0.2785-0.396	

When the simple LG tax rate formulas in Table 4 are used to replace the Tax Tables (12 pages), the filing status is simplified and improved significantly. The results are very compatible. Figure 1 shows tax rate differences between the LG tax system and the 2014 Tax Tables and Tax Computations. There are minor differences, with low taxable incomes of less than $1,000. From the existing Tax Table, there are tax rates at low

taxable incomes from \$5 to \$1,000, and tax rates from 20% to 16%, and 11% respectively, which are not reasonable. The tax rates at low taxable incomes (< \$1,000) should be close to 10%.
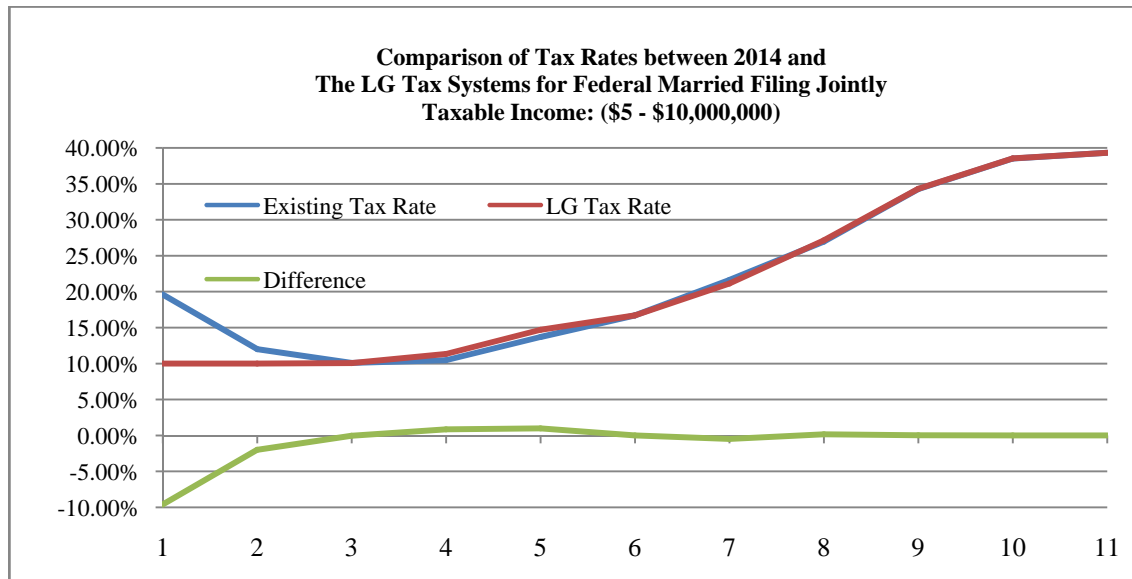

Figure 1   The Existing Federal Individual Tax System and the LG Tax System

Note: (Taxable income: 1 = \$5.1, 2 = \$50.1, 3 = \$1,001, 4 = \$20,000, 5 = \$70,000, 6 = \$100,000, 7 = \$200,000, 8 = \$400,000, 9 = \$1,000,000, 10 = \$5,000,000, 11 = \$10,000,000)

For different filing periods, employers may consider filing period factor (F) and government regulations in modifying tax rate formulas. Table 5 shows different filing period factors. For tax simplification and reform, these constants (a, b, c and d) in the LG tax system (Tax rate= a + TI/b or c − d/TI) may be modified and adjusted in a more efficient way. In y = a + x/b, tax rates (y) against taxable incomes (x) change smoothly with constant slope 1/b, which is not related to taxable income and is more reasonable. The equation y = a + x/b is suggested to be used for all taxable income ranges except last taxable income range. In y = c - d/x, the tax rate slope relates to taxable income and always changes at d/x^2, which is used in the existing U.S. federal systems. For the last taxable income range, y = c - d/x is suggested.

Table 5   The LG Tax Rates for Federal and State Taxpayers on Different Filing Periods

D (daily)	W (weekly)	BW (biweekly)	SM (semi-month)	M (month)	Q (quater)	SY (semi-year)	Y (annually)
365	52	26	24	12	4	2	1

When employers and employees (individuals) use the same LG tax system (Table 4) instead of the two tax systems (Tables 1, 2, and 3), both employers and individuals have the same standard and reference to be used for comparison. Employers use the LG tax system (Table 4) to calculate withholding income taxes and transfer the taxes to governments. When employees provide accurate tax information such as filing status, exemption number, retirement, deductions, and credits, withholding income taxes will be more accurate. Especially, employees have non-complex tax situations with stable incomes, fixed retirement, standard deductions, and credit for incomes that are less than \$100,000; accurate income taxes can be calculated by employers. These employees may have the option to let the IRS and state governments know that they would not file tax returns, or their tax returns are for recording purposes only because there is no or just a very minor difference between withholding income taxes and taxes in tax returns. Lower tax return numbers can reduce the governments' processing work during the tax season,

which is helpful for governments to verify more tax returns and reduce potential tax evasion.

2.2.2 Tax Refunds, Timing, and Verification

Employers estimate income taxes according to different filing periods. Annual tax withholding reports can be complete and reported to the IRS and state governments by January 15 or 31. When employers withhold taxes, information such as name, Social Security number, filing status, exemptions number, retirement, child credit, and work hours are required. Then, related taxes and tax rates are calculated and recorded. The tax withholding report for each employee can have information, including name, Social Security number, filing status, exemption number, retirement, deductions, credits, taxable income, tax rates, taxes paid, and address. Taxpayer's filing status, exemption number, retirement, deductions, credits, gross income, taxable income, tax rate, and taxes paid could be used for detail comparisons and verifications, which can be done automatically when the IRS and state governments receive tax returns. Filing status, exemption number, deductions, credits, taxable income, tax rates, and taxes paid are not covered on W-2 form. Tax withholding reports improve W-2 forms. If there is an unmatched item or a large difference such as a taxable income difference of more than $50,000 or a tax rate difference of more than 30%, tax refunds can be held for further inspection, which may reduce or prevent potential tax fraud.

From the timing issue, the tax report summary can go to the IRS and state governments electronically by January 15 or February 15 with minor modifications. Some individuals, who meet certain conditions, such as a gross income of less than $100,000, interest/capital gains of less than $2,000, and a tax difference of less than $1,000 may have the option to not file tax returns by sending tax withholding reports without or with minor modifications. Their tax returns are for recording purposes, and related tax refunds (such as those less than $100) may be transferred to the next year. Some employees may modify their tax information non-significantly through their employers electronically by February 10. Then, the IRS and state governments have all employees' tax information such as filing status, exemption number, retirement, deductions, credits, gross income, taxable income, tax rates, and taxes paid by February 15. Before receiving tax returns by April 15, the IRS and state governments already have tax information and there is enough time to verify the tax returns for all employees when tax returns or tax withholding reports are submitted. If employees change tax information (except deductions, retirement, credits, and income) between their employers' reports and tax returns, their tax refunds may be postponed reasonably because of the significant changes, which need verification. The LG tax system could help the IRS (and state governments) reduce or prevent potential tax evasion.

Related computer programs that calculate taxable income, tax rate, and tax amount automatically were developed for the LG federal individual tax system in 2012, 2013, 2014, and 2015 in some states with complex individual tax situations such as CA and HI. A tax filing status from the four statuses is selected. When gross income, exemptions, retirement, deductions, credits, and withholding income tax are inputted, the computer programs recognize the tax filing status, pick up the related LG tax rate formula and calculate taxable income, tax rate, tax refunds, or tax due automatically. A tax rate range check is provided to check the tax rate calculation, which must be within the narrow tax rate range check to reduce calculation mistakes.

2.2.3 Tax Return Option on Filing Exemption from Tax Withholding Reports

The total amount of resources needed to support the IRS activities for FY 2012 is about $13.6 billion, which is $1.5 billion more than the FY 2010 level of $12.1 billion. The IRS' collection cost was $4.7 billion in 2011 (Greenberg, 2015). The simple linear and gradual (LG) tax system provides governments, employers, and individuals with the ability to calculate accurate taxes annually, which may help many taxpayers with non-complex tax situations such as one income source, less than a $100,000 income, an unchangeable filing status,

and an exemption number to match withholding income taxes with tax returns. Many taxpayers may have the option to file no tax returns. Tax returns may be replaced by tax withholding reports without or with minor modifications. If 30% tax returns are reduced, billions of dollars can be saved, and that can reduce potential tax evasion.

Example 2: A mother as Head of Household with two dependents (under 17) has one income source at $75,000 annually. She claims standard deductions. Her employer deducts related tax payments (including withholding income tax) for every two weeks and for the entire year. Her Standard Deductions in 2014 are $9,100 for Head of Household and $3,950 for each personal exemption. Other deductions are various, such as retirement, a health deduction, and credit. Her retirement is $300 biweekly. Each child renders a tax credit of $1,000. Tax data may be calculated by a computer software product automatically.

Taxable Income (TI) = Income (I)–Standard Deductions (SD)–Exemptions (E)–Other Deductions (OD)   (2)

(1) Gross Income (two weeks): 75,000/26 = 2,884.62

Taxable Income = 75,000 – 9,100 – 3,950 × 3 – 300 × 26= $46,250

(Two weeks) = 2,884.62– (9,100 + 3,950 × 3)/26 – 300 = 1,778.85

Tax Rate = 0.1 + TI/1,062,699.3 (2/1) = 0.1 + 46,250/1,062,699.3 = 14.35%   (3)

Income Tax (two weeks) = Tax Rate × 1,778.85 – 1000×2/26 = $178.38

(2) There is an additional payment of $2,500 (bonus or salary increase) in December:

Final tax rate = 0.1 + TI/1,052,631.6 (2/1) = 0.1+ (46,250 + 2,500)/1,062,699.3 = 14.59%   (4)

Total income tax = Final tax rate × 48,750 – 2000 = $5,111.35   (5)

Last income tax payment = 5,111.35 – 178.38 × 25 = $651.85   (6)

The IRS may have her detailed tax information records from her employer (tax withholding report) as Head of Household with two children, one income source ($75,000+2,500) annually, Standard Deduction at $9,100, three exemptions, retirement at $7,800, child credit at $2,000, taxable income at $48,750 and total withholding income taxes of $5,111.35 at an annual tax rate of 14.59% from her employer's tax summary reported by January 15 or 31. She may have the option to not file tax returns by sending tax withholding reports without or with minor modifications if she has total interest and capital gains of less than $3,000.

Example 3: A man who files as a Married Couple with two children; he works and lives in California and has a one-source annual income of $95,000 from his company. His employer may use our tax software product to deduct related withholding taxes and credits on a biweekly and annual basis. His federal standard deductions are $12,400 for Married Filing Jointly, and $3,950 for each personal exemption. He has state standard deductions of $7,812, an exemption credit of $212 for Married Filing Jointly, and a dependent exemption credit of $326. He has one child credit for a federal tax return. His retirement savings payment is $146.15 biweekly, and his medical insurance costs $153.85 biweekly.

His employer calculates that his initial federal income tax rate is at 13.96%, and his income tax (biweekly) is $278.30. His withholding taxes (biweekly), including withholding income tax, Social Security, and Medicare from both employee and employer are $837.34 for the federal government. His initial California income tax rate is at 3.13%, and his income tax rate (biweekly) is $53.59 for his state. His biweekly payroll is $3,042.44. By the end of the year, if he receives a bonus of $4,500, which needs to be adjusted, his annually overall federal income tax rate is 14.26%, which is slightly increased from 13.96%. His total withholding taxes, which include total income withholding tax, Social Security, and Medicare from both him as an employee and his employer are $23,279.14 to the federal government. His total federal income tax is $8,055.64. His annual overall California income tax rate is

3.24%, which is slightly increased from 3.13%. His total state taxes are $1,590.73 to the State of California. His last biweekly payroll amount was $6,180.84 in the month of December. His annual total federal taxable income was $63,500. His annual total payroll is $82,241.88. These calculated numbers are shown by the tax software automatically.

The IRS may have his tax records from his employer's tax withholding report of Married Filing Jointly with two dependents, one-income source of $95,000 annually, a Standard Deduction of $12,400, a retirement payment of $3,799.90, total federal withholding income taxes of $8,055.64 at 14.26%, and state income taxes of $1,590.73 at 3.24%. The State of California may have his state tax records of $1,590.73 at 3.24% besides his tax filing status, exemptions, deductions, retirement, and taxable income. If the family has no other income except from their bank saving interest of $225.87, which may be not considered as a major taxable income or use the above federal and state deductions and tax credits, the family has income taxes the same as $8,055.64 and $1,590.73 respectively for the family to file the federal and state tax returns. The family may have an option to file on the federal and state tax returns or use tax withholding reports with or without minor modifications.

If he reports the above bank savings interest of $225.87 to his employer or the IRS and adds it as his income, the family needs to pay a total federal income tax of $8,097.51, with a difference of $41.87 and total state tax of $1,600.82 with a difference of $10.09, which is shown by the tax software product automatically. Total extra federal and state taxes are $51.96 (= $41.87+$10.09). It is not worthwhile to file federal and state tax returns by paying an extra $41.87 to the federal government and $10.09 to the state government, which involve more tax processing costs and time for the governments. This case was discussed at the 2015 AEF Conference (Kao & Lee, 2015). If bank interest and investment capital gains are less than $3,000 and federal tax differences are less than $1,000 between income withholding tax and calculated tax on the federal tax returns, it may be suggested to offer these taxpayers an option to file no federal tax returns with use tax withholding reports with or without minor modifications to replace their tax returns, which reduce tax return numbers for saving tax processing time and costs, and eventually reduce potential tax evasion.

3. Conclusion

The three major reasons to cause potential tax evasions or noncompliance are discussed in this paper. The IRS and many state governments have two tax systems for employers and individuals separately. Tax schedules and the related withholding tables are used to estimate withholding income taxes. Tax Tables and Tax Computations are used for individuals to calculate tax returns. The two tax systems are not connected with each other directly. Employers and individuals have different standards or references, and two tax systems may have similar tax rates with no or very minor differences. Timing is also a problem in processing; so many tax returns are made during the tax season. Detailed tax information, such as tax filing status, exemptions, deductions, taxable income, overall tax rate, and tax amounts are not known by the IRS (and state governments) before receiving tax returns by April 15. When receiving tax returns from individuals, the IRS and state governments have no detailed tax information such as references to compare and verify these tax returns, which may allow for fraud via possible tax evasion.

The current two federal individual tax systems with Tax Schedules and Tax Tables/Tax Computations have been recognized and combined. Governments, employers, and individuals can use the same LG tax system as standard and common reference. Employers can provide tax withholding reports with detailed tax information, such as tax filing status, exemptions, deductions, taxable incomes, tax rates, and taxes paid, which are not covered on

W-2 forms by March 15 to the IRS and state governments by January 31 or February 15. Before receiving tax returns by April 15, the IRS and state governments already have tax information and enough time to verify tax returns for all employees, which could help the IRS and state governments to reduce or avoid potential tax fraud.

The supporting computer programs that calculate taxable income, tax rates, and taxes paid automatically have been developed according to tax filing status, gross income, exemptions, retirement, deductions, credits, and withholding income tax. The computer programs recognize tax filing status, pick up related LG tax rate formulas, and calculate taxable income, tax rates, tax refunds or taxes due automatically.

There are about 138 million federal tax returns per year. The average cost of the estimated average taxpayer burden for individuals is about $210 via the IRS. If 20% of tax returns are exempted out of total filings, the substantial amount of $5.8 billion can be saved. Significant time and costs could be reduced for the IRS and state governments. When tax return numbers are reduced, potential tax evasion or tax noncompliance could also be reduced. The benefits would result in more efficient use of resources, promoting an equitable distribution of the taxes, and increasing public revenues.

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