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CONSEQUENCES OF NON-TAX COMPLIANCE: A COMPREHENSIVE ANALYSIS OF POTENTIAL REVENUE LEAKAGE AND ITS IMPACT ON FEDERAL INFRASTRUCTURE INVESTMENT

Charles Kudzayi Makoni [a], Jehu Emefa Nii-Laryea Laryea [b]
[a] *Great Zimbabwe University, Harare Campus, Zimbabwe*
[b] *Department of Business Administration, University of Professional Studies, Ghana*

**Corresponding Author: Jehu Emefa Nii-Laryea Laryea*

ABSTRACT

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This paper examines the multifaceted nature of tax compliance gaps in the United States and their extensive, often overlooked, consequences on federal infrastructure investment and ultimately, overall economic development performance. The gross federal tax gap, representing the difference between taxes legally owed and those collected on time, was projected at approximately $601 billion in 2020 and has since risen to an estimated $688 billion in 2021 and nearly $700 billion in 2022, highlighting its continued growth in recent years. While the direct revenue loss is a critical fiscal concern, the analysis in this paper extends beyond these headline figures to explore the less visible but equally significant systemic costs challenges of the United States tax system, including administrative complexity, regulatory uncertainty, excessive time burdens, and compliance expenditures that disproportionately affect small businesses, lower-income households, and taxpayers with limited access to professional advisory services. Such inefficiencies divert capital and labor from productive economic activity, discourage voluntary compliance, and erode public confidence in the administration of the tax laws. Drawing from peer-reviewed literature, empirical data from the Internal Revenue Service and Congressional Research Service, and policy analyses from reputable institutions, the study assesses the composition, causes, and distributional effects of the compliance gap, specifically the trend in enforcement, the loss of IRS capacity through budgetary cuts, and the unfair concentration of audit resources on low-income taxpayers alongside the insufficient auditing of high-income individuals and large corporations. These dynamics not only exacerbate inequality but also compromise enforcement deterrence, allowing underreporting to persist. By quantifying the opportunity costs of noncompliance, particularly the foregone capacity to fund long-term, high-impact infrastructure projects, the research establishes a stronger conceptual link that exists between fiscal inefficiency and underinvestment in public goods. The annual net tax gap exceeds typical yearly budgets allotted by the Bipartisan Infrastructure Law, underscoring the potential for improved compliance to serve as a sustainable revenue source the need to raise statutory tax rates. In doing so, the study positions the tax gap not merely as a technical issue of collection but as a structural limit on economic growth, competitiveness, and equity, and it ends with policy-relevant recommendations intended to improve compliance, modernize enforcement, and rebalance federal fiscal capacity with long-term development objectives.

KEYWORDS: ***Tax compliance gap, Revenue leakage, IRS enforcement, Hidden compliance costs, Infrastructure investment, Fiscal capacity***

INTRODUCTION

Tax compliance gaps are a systemic and accumulating long-term issue of the U.S. fiscal policy. Such gaps indicate the disparity between the taxes payable and tax penalties and accrued interest at prevailing interbank rates, the fines imposed as a result of non-filing/compliance, underreporting, and underpayment, limiting public revenue available for long-term investment (Sarin & Summers, 2019). According to the Internal Revenue Service, the gross federal tax gap in 2011-2013 tax years was approximately 441 billion dollars annually and the latest estimates show that it increased to over 600 billion dollars (Internal Revenue Service, 2019; McDermott, 2023). Although the direct revenue losses are large, the wider economic and policy consequences have been sparsely researched. This compliance gap will undermine the Government's fiscal planning, limit the discretionary capacity of the federal government, and limit investment funding in core areas such as infrastructure, climate adaptation, and digital equity.

Beyond the revenue shortfall, the U.S. tax system creates large hidden compliance costs on individuals, businesses, and government institutions. These involve administrative complexity, regulatory uncertainty, legal and lobbying costs, as well as time and resource costs incurred in tax preparation. According to Fichtner and Feldman (2013), these invisible costs are between 215 and 987 billion dollars per year. These burdens not only diminish economic efficiency but also impact small and medium-sized enterprises, households with a lower income, and taxpayers with low access to advisory services disproportionately (George, 2019). In the meantime, the IRS enforcement has been undermined by budget reductions and technological disadvantage, which have led to insufficient oversight of the high-income population and large businesses and increased vertical inequities in compliance (Black et al., 2022).

It is worth noting that the implications for infrastructure investment are particularly pressing. The annual net tax gap is larger than the legally authorized federal infrastructure expenditures, which is approximately 150 billion dollars per year, or less than half of the potential revenue forgone as a result of noncompliance (Washington, 2019). These opportunity costs highlight the economic consequences of inefficiencies in tax policy. This paper provides an in-depth analysis of the visible and unseen expenses of the tax compliance gaps, as well as their effects on the investment in infrastructure. It is a synthesis of U.S. recent empirical literature, government reports, and policy analyses to comprehend the fiscal, behavioral, and institutional dynamics of the tax gap and the strategic reforms required to modernize the IRS and realign public finance with long-term developmental goals.

Methodology

The literature review employed a narrative synthesis approach grounded in peer-reviewed journal articles, government reports, and policy research produced by reputable institutions. The analysis prioritized sources that are verifiable via Google Scholar and published by entities such as the Internal Revenue Service (IRS), the Congressional Research Service (CRS), the Treasury Inspector General for Tax Administration (TIGTA), the Center on Budget and Policy Priorities (CBPP), as well as the National Taxpayer Advocate.

While the conceptual framework draws from foundational literature, only studies with empirical or policy-based analysis published after 2015 were used in the review to make them relevant to and consistent with the latest fiscal and institutional realities. Specific focus was put on materials that discuss enforcement trends, administrative burden, audit coverage, and revenue implications for public investment planning.

LITERATURE REVIEW ON TOPICAL AREAS

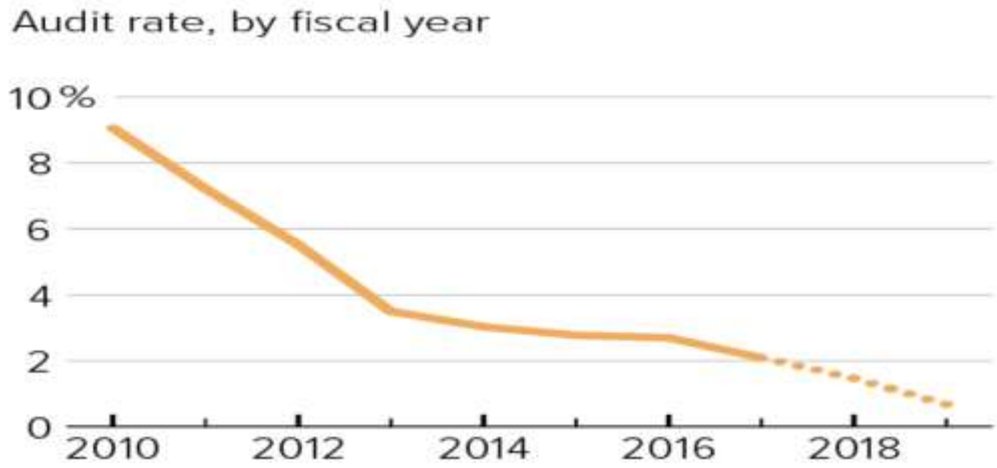
Tax Gap Composition and Trends

The Internal Revenue Service defines gross tax gap as the total amount of tax liability that is not paid voluntarily at the due time. The gross gap averaged 441 billion dollars per year in the tax years 2011 through 2013. About 352 billion were not reported, 39 billion were not filed, and 50 billion were underpaid (McDermott, 2023). The net tax gap was estimated post-enforcement and late payment at 381 billion dollars. Recent evaluations of the Internal Revenue Service estimate that the gross tax gap has increased to more than 600 billion dollars per year (see *Figure 2*) and reached 601 billion in 2020 and 668 billion in 2021, whereas the net tax gap has been estimated to have reached 539 billion in 2020 and 625 billion in 2021 (Internal Revenue Service, 2023). In the meantime, the amount of coverage and enforcement resources has been slashed, the audit rate of million-dollar earners dropped by more than sixty percent in the period between 2010 and 2019, and enforcement outlays decreased by twenty-six percent during the period between the fiscal year 2010 and the fiscal year 2022 (Internal Revenue Service, 2023; Peterson Foundation, 2023).

Policy analysts and Economic commentators have traced this to the recurrent underfunding of the IRS revenue collection operations, the weakened third-party information reporting, and the outdated electronic computer systems as reported by Marr et al. (2022). Furthermore, in this first analysis, it is worth noting the uneven distribution of the tax gap across the various types of income (*Figure 3*). There is a high compliance rate on wages that are subject to third-party reporting while withholding and business income and capital gains are often underreported because of their more opaque and complex form (Slemrod, 2019). Black et al. (2022) stresses that structural inequities in the distribution of audits contribute to the growing disparities, as high-income filers increasingly escape scrutiny while lower income earners face higher audit rates due to automated enforcement targeting refundable credits (*see Figure 1*).

Figure 1

IRS Audits on Millionaires Have Plummeted



Note. Source: Marr et al. 2022

Hidden Costs of Compliance

Beyond measurable revenue shortfalls, the U.S. tax system imposes substantial compliance burdens that presents some hidden costs to individuals and firms. These hidden expenses come in the form of labor hours spent preparing the taxes returns, tax consultants' fees, and resources to comply with complicated and changing tax laws. According to Holtzblatt and McGuire (2016), recent tax policy changes have made reporting more complex, particularly to small and medium-sized businesses and sole proprietors, which has magnified the marginal cost of non-compliance and decreased the incentives to accurately and promptly self-report. The economic implications of these burdens are that they divert labor and capital from productive activities.

The compliance burden is unevenly distributed across taxpayers, putting those without access to professional tax advice or automated reporting systems at a disadvantage. At the same time, high-income individuals and large corporations can leverage legal expertise in tax planning to minimize tax liabilities while incurring relatively lower compliance costs per dollar of income. These disparities not only reduce administrative efficiency but also undermine perceptions of fairness, thus diminishing voluntary compliance and trust in the system (Holtzblatt & McGuire, 2016; Black et al., 2022). The fall in the rate of audits and enforcement capacity by the IRS, as documented by Marr et al. (2022) and McDermott (2023), also hinders the ability of the IRS to seal these structural gaps. This, in turn, leads to the leakage of revenue, contributing to the chronic underfunding of the public infrastructure (see *Figure 1* above).

Enforcement and Administrative Capacity

The workforce of the Internal Revenue Service (IRS) decreased by more than 20 percent between 2010 and 2018, whereas the number of revenue agents decreased by nearly 30 percent during the same period, even though the number of tax returns filed was on the rise (U.S. Department of the Treasury, 2021). This reduction in IRS resources is believed to have caused a sharp decrease in the number of audits, especially among high-income earners and large corporations, where audit coverage of the millionaires reduced by over 75 percent (Sarin & Summers, 2019). Analysts believe that have repeatedly cited this attrition to years of budgetary shortages and archaic technology that have hampered the IRS in its efforts to identify underreporting, audit complex returns and enhance compliance. The population of the most affluent filers, those who engage in the most extreme tax avoidance behaviors, has become the target of a severely limited enforcement effort (Guyton et al., 2021).

Recent empirical research demonstrates the fiscal returns from bolstering enforcement capacity. Guyton et al. (2021) estimate that the audit of the highest 0.1% of earners generates more than six dollars in revenue per dollar employed, and the effect of randomized audit trials demonstrates long-run compliance effects. Advancements in enforcement analytics, such as machine learning models for risk scoring, are improving targeting efficiency and reducing false positives (Boning et al., 2025). Although analysts believe that new hires and IT upgrades under the Inflation Reduction Act of 2022 will increase audit coverage of high-income earners by a factor of two, they warn that political uncertainty and funding rollbacks will undermine these advances. Although analysts believe that new hires and IT upgrades under the Inflation Reduction Act of 2022 will increase audit coverage of high-income earners by a factor of two, they warn that political uncertainty and funding rollbacks will undermine these advances (Congressional Research Service, 2023). The scholarly consensus emphasizes that a trend of chronic underinvestment in tax collection increases the tax gap and decreases the fiscal space to pursue long-term development goals.

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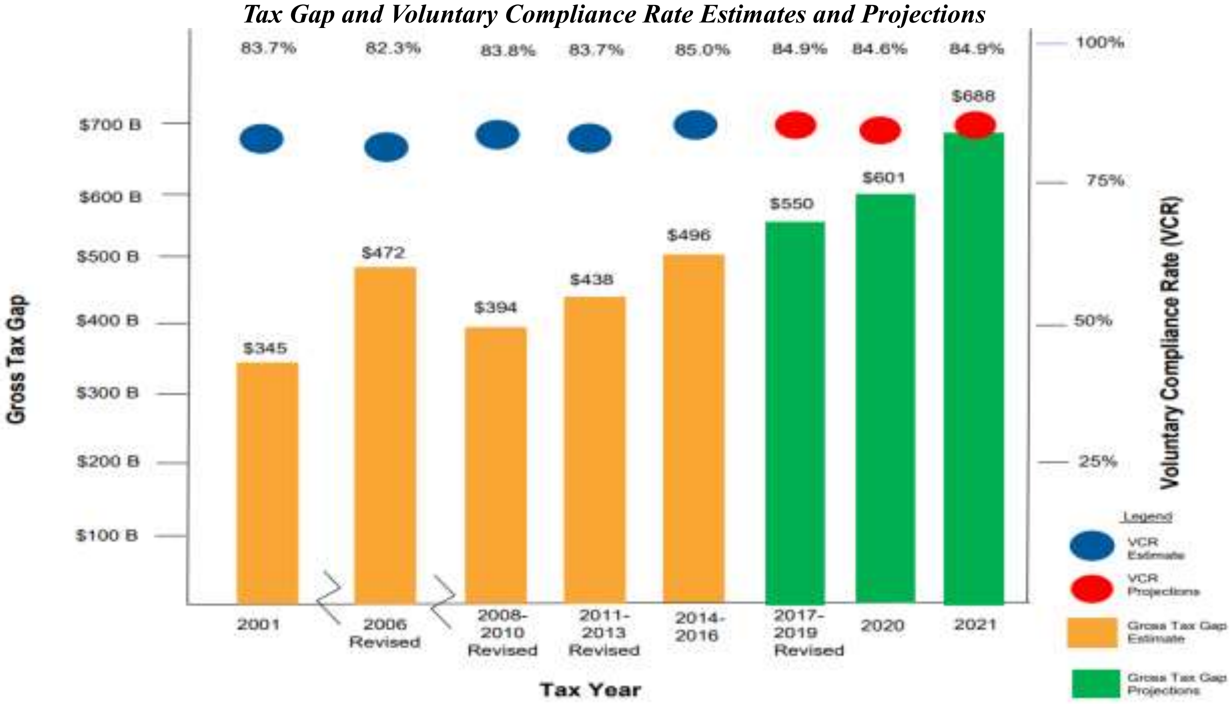
Figure 2.
Tax Gap and Voluntary Compliance Rate Estimates and Projections



Note. Source: Internal Revenue Service, 2023

Impact on Infrastructure Investment

The existing tax compliance gap is worth hundreds of billions of dollars yearly, directly hindering the amount of funding available to support public infrastructure and social investment (U.S. Department of the Treasury, 2021). These unpaid dues amount to substantial foregone revenue to fund the repairs and maintenance work to deal with the aging infrastructure across the country, especially in public transportation, internet, telecommunication, broadband, water, and energy infrastructure. Recent empirical analysis indicates that an increased focus on IRS enforcement and compliance activities can yield significant additional revenue, with reports suggest that closing the gap would create fiscal space large enough to fund significant shares of the federal infrastructure backlog, reducing the need to finance the backlog using deficit financing or cuts to other priorities (Boning et al., 2024; Sarin & Summers, 2019). Furthermore, lack of revenues due to tax noncompliance puts federal governments in a difficult position where they must make tough trade-offs that prioritize short-term mandatory expenditures over long-term capital investments, which highlights the symbiosis between effective tax administration and the sustainability of federal investment plans (Congressional Budget Office, 2020).

In addition to limitations in direct funding, the infrastructure gaps result in longer-term economic implications. Bom and Ligthart (2014) suggest that public capital increases output and productivity; thus, recurring deficits in the supply reduce growth and limit convergence in the living standards of the regions (Bom and Ligthart, 2014). The reliability and soundness of fiscal and regulatory regulations can also influence the involvement of the private sector in the public-private partnership infrastructure market, where better governance systems increase the positive impact of risk distribution on the investment of the private sector (Wang et al., 2019). Some recent policy frameworks, such as those outlined in the U.S. Department of the Treasury (2021), have been based on the estimated IRS enforcement gains, which will be used as revenue offsets. These results emphasize the fact that the tax gap is not merely a revenue problem but a problem of inclusive and future-oriented development.

Key Findings

1. The U.S. tax gap remains a substantial and persistent threat to fiscal health

The amount of gross federal tax gap (difference between taxes owed and taxes collected on time) was roughly 441 billion dollars per year in 2011-2013, and the net gap (after enforcement activities) of 381 billion dollars (McDermott, 2023). Recent IRS estimates and other projections indicate that the gap could now be more than 600 billion dollars a year (as shown in *Figure 2*). Such a constant loss in revenues greatly compromises the capability of the federal government to balance its budgets, fulfill its mandates of providing services to its people, and invest in infrastructure and other capital-intensive projects. The relative stability of the tax gap, even in the face of marginal enforcement, evidences a structural problem in U.S. tax administration.

2. Hidden compliance costs versus economic performance

Besides uncollected tax, the complexity of the U.S. tax code also has significant compliance costs to households, businesses, and even the IRS. According to Fichtner and Feldman (2013), the total of these hidden costs, such as the time spent filing, money paid to tax preparers, and the cost of lobbying to receive favorable treatment, is estimated between 215 billion and 987 billion dollars per year. Such expenditures do not have a direct budgetary impact on federal revenues but are an actual waste of resources and productivity in the economy. The compliance burden can be disproportionately greater on small businesses and middle-income households, and can be a source of concern with respect to both efficiency and fairness.

Table 1

Average Net Misreporting for Individual Income Tax Filers by Income Level

	Average underreporting percentage
Under $200,000	2.6%
$200,000 under $500,000	4.5%
$500,000 under $1,000,000	6.7%
$1,000,000 under $5,000,000	9.1%
$5,000,000 under $10,000,000	11.1%
$10,000,000 or more	13.9%

Note. Source: Sarin & Summers 2019

3. Erosion of IRS enforcement capacity exacerbates noncompliance and widens inequality

Over the last decade, the IRS has faced declining budgets, staff reductions, and outdated technology systems. According to George (2019), enforcement staff have decreased by 38 percent since 2010, and the level of audits and tax assessments has fallen significantly. Especially, audit coverage of large corporations and high-income earners who engage in most of the underreporting has decreased. This enforcement gap not only allows noncompliance to continue but also lowers the morale of the taxpayers due to the sense of inequality in the tax laws as applied to them. The weakened deterrence effect also causes the gap to remain.

4. Tax compliance shortfalls directly limit federal infrastructure investment capacity

While few studies explicitly quantify the relationship between the tax gap and infrastructure investment in the U.S, the literature implies a direct fiscal trade-off. Washington (2022) notes that the annual net tax gap could fully fund the entire capital outlay of federal infrastructure programs such as the Highway Trust Fund, Amtrak expansion, and broadband access initiatives. Comparatively, the Bipartisan Infrastructure Law (2021) appropriated approximately one-half of the annual tax gap, or about 1.2 trillion dollars over eight years, or 150 billion dollars per year. Hence, better compliance would completely transform the capacity to undertake infrastructure policy without any rise in tax rates.

5. Audit Disparities and Equity in Tax Compliance

New studies, including work by Black et al. (2022), have revealed that low-income earners, particularly those who receive the Earned Income Tax Credit (EITC), are over-audited compared to their wealthier counterparts, as shown in *Table 1*. Part of this is because of automated risk models, which tag easily verifiable income Support claims and overlook sophisticated underreporting by richer individuals and businesses. Such an inverted audit structure is not only a cause of concern regarding vertical equity but can also lead to low compliance of low-income taxpayers based on a sense of unfairness. Moreover, companies that have the resources to navigate tax regulations and take advantage of loopholes are more likely to have an advantage and, therefore, are less likely to be burdened by enforcement, furthering structural inequality as shown in *Figure 3*.

6. There is an urgent need for IRS Systems modernization and policy reform

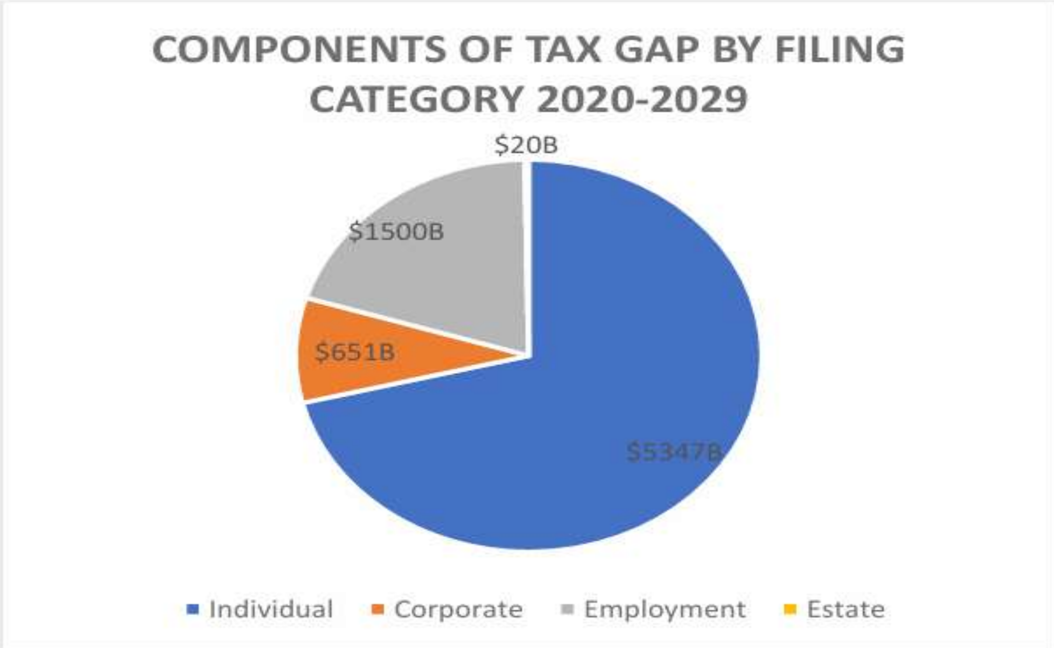
Despite acknowledgment of the tax gap, the literature stresses that it will take more than incremental funding to reduce the gap sustainably. Investments in artificial intelligence, data analytics, pre-filled returns, and enhanced taxpayer services could modernize the IRS and improve voluntary compliance at a lower administrative cost. Research demands new reforms that would make the tax code less complex, high-risk loopholes closed, and enforcement proportionate and fair. In addition, the quantification of the return on investment of such reforms is a critical research and policy agenda going forward.

7. The effects of inaction are costly in the long term and accumulate annually

Turning a blind eye to the compliance gap will not only lead to a continued loss of revenue and to long-term compounding effects on the formation of public capital, the productivity of the economy, and equity. The annual shortfall in investment in infrastructure would cause depreciation of assets, leading to higher costs of maintenance in the years to come and less economic efficiency. The effects of poor tax compliance are long-term because it goes beyond fiscal parameters to include reduced competitiveness, weak climate resilience, and minimized quality of life for American communities.

Figure 3

2020-2029 Projected Tax Gap by Filing Category



Note. Source: Sarin & Summers 2019

Future Directions and Research Gaps

1. Establishing empirical models that directly link tax compliance improvements to infrastructure investment outcomes

Although multiple sources highlight that the annual tax compliance gap exceeds typical federal infrastructure spending, few empirical models quantitatively map this relationship. There is a pressing need for dynamic fiscal models that simulate how incremental improvements in tax collection, driven by enforcement or administrative reforms, result in expanded capacity for federal infrastructure programs. Such modeling would enable policymakers to estimate opportunity costs and assess fiscal multipliers in infrastructure-specific industries like transportation, energy, water systems, and digital access.

Subsequent studies can draw from the approach to fiscal sustainability modeling adopted by the Congressional Budget Office and the Urban-Brookings Tax Policy Center and apply it to the cases of compliance enforcement and capital investment correlations.

2. Evaluating the cost-effectiveness and return on investment of IRS modernization efforts

Few studies conduct a strong cost-benefit analysis of the investments in the IRS modernization programs, like artificial intelligence, enhanced data analytics, e-filing systems, and enhanced taxpayer service infrastructure. Further development of this research stream would make it possible to quantify the return on each dollar invested in IRS capacity in terms of fiscal returns in terms of resulting voluntary compliance or deterrence. Current reviews are either descriptive or too general and do not have real-time measurement frameworks, which take into consideration behavioral responses by the taxpayers and businesses.

The future research could be based on the simulating frameworks created by the National Taxpayer Advocate or the policy organizations, such as the Tax Foundation, and used with the disaggregated data and sectoral differentiation.

3. Disaggregated analysis of compliance costs by sector and taxpayer type

The existing literature largely presents compliance costs in aggregate form, often based on survey data or modeling assumptions. There is a gap in understanding how compliance burdens differ across industry sectors, income groups, and business sizes. For example, large infrastructure contractors may face disproportionate compliance burdens due to the intersection of federal and state tax codes, while sole proprietors or gig economy workers may struggle with a lack of clarity or access to affordable tax advisory services.

Disaggregated research would also allow the IRS and policymakers to tailor compliance frameworks more closely, streamline rules in high-compliance-cost areas, and better understand how people respond to tax rules behaviorally. and behavioral responses to tax rules.

4. Longitudinal research on taxpayer behavior and deterrence

Although a number of IRS and Treasury reports have made static estimates of noncompliance, there is limited longitudinal research to trace the evolution of taxpayer behavior in response to enforcement, simplification, or information campaigns. Behavioral insights are especially relevant in determining why high-income earners or some business entities continue to be noncompliant and how the perception of the likelihood of audit or fairness in the system would influence compliance choices over time.

A behavioral public finance framework, as advanced by Slemrod (2019), may have greater applicability with IRS administrative data to examine the compliance lifecycle of various taxpayer categories.

5. Investigating equity implications of compliance and audit structures

More recent studies have started to demonstrate how audit algorithms and patterns of enforcement can unwittingly replicate social and racial inequalities. Black et al. (2022) reveal that low-income taxpayers are audited at a higher rate than higher-income taxpayers with a complex return, especially those who claim the Earned Income Tax Credit. Additional studies are needed to learn more about the implications of these enforcement asymmetries on trust and the willingness of taxpayers to comply with the tax system and the perceptions of fairness.

The study should be put in the larger context of distributive justice, with interdisciplinary perspectives of law, sociology, and public administration.

6. Studying taxpayer trust and compliance in the context of public investment outcomes

One relatively unexplored research direction is the role of visible and effective spending of public money on voluntary compliance, with infrastructure as a notable example. International research findings indicate that the existence of perceptions of efficiency and service delivery of the government has effects on tax morale. There is little empirical work in the U.S. context that explores the question of whether taxpayers are willing to pay more taxes when they believe that the taxes they pay are used to make tangible, well-managed investments in transportation, health, and education.

Future research efforts should combine public finance with research on public perception tools, including taxpayer satisfaction surveys, experimental research, and cross-municipal data.

CONCLUSION

The ever-evolving persistence of tax compliance gaps in the United States is indicative of more than just lost tax revenues; it is a structural problem with far-reaching fiscal and economic implications. These deficits undermine the fairness and effectiveness of the tax system, as well as limiting the federal ability to invest in infrastructure that is essential to long-term growth. The problem is compounded by hidden compliance costs, the shrinking enforcement resources of the IRS, and unfairness in the allocation of audits that undermine confidence and place an unfair burden on small businesses and low-income families. The tax gap is not only an issue of collection efficiency, but also one about fiscal capacity, equity, and inclusive growth. Finally, it is worth noting that the revamp and upgrade of IRS systems, increased enforcement against high-income noncompliance, and simplification of tax administration would free up resources that would be used to address substantial infrastructure needs, diminish the use of deficit financing, and strengthen the federal fiscal policy credibility.

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