

Reducing Individual Tax Evasion with the LG Tax System

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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 tax fraud. Oftentimes, the IRS and many state governments processed two tax systems for employers and individuals. These different systems would cause employers and individuals to have diverse standards or references to similar tax rates. On another occasion, before sending out tax refunds from the IRS and state governments, the detailed tax information on taxpayers' filing status, deductions, exemptions, taxable income, and others are unclear and not determined. The W-2 Form provides only limited information for the IRS and state governments to process individual returns. This paper enlightens these two major loopholes and provides a proposed LG tax system to reduce some potential tax noncompliance issues, which could save significant costs for both individuals and governments.

Introduction and Literature Reviews

Tax evasion is a practice of tax fraud when the taxpayer is deliberate attempt to misrepresent personal or entity taxable income to the Internal Revenue Service (IRS) and state governments. This kind of intentional tax liability's concealment to the government by not paying its taxes is illegal and punishable. Tax invasion involves of several deceitful forms, including taxpayers may try to under pay, or to avoid paying taxes altogether, by underreporting or omitting their income, overstating expenses or deductions, engaging in accounting irregularities, or hiding or transferring income or assets.

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 provide the IRS with information about tax law violations. Under section 7201 of the Internal Revenue Code, tax evasion which is punishable by 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 disclosure from individuals who are aware of significant incidents of tax fraud.

In the IRS 2001 report, the underreporting of income remained the biggest contributing factor to the tax gap in 2006. Under-reporting across taxpayer categories accounted for an estimated \$376 billion of the gross tax gap in 2006, up from \$285 billion in 2001. Tax non-filing accounted for \$28 billion in 2006, up from \$27 billion in 2001. Underpayment of tax increased to \$46 billion, up from \$33 billion in the previous study. Overall, compliance is highest where there is third-party information reporting and/or withholding. For example, most wages and salaries are reported by employers to the IRS on Forms W-2 and are subject to withholding. As a result, a net of only 1 percent of wage and salary income was misreported. But amounts subject to little or no information reporting had a 56 percent net misreporting rate in 2006. Thus, there was 18 to 19 percent of total reportable income is not properly reported to the IRS. In 2010, tax revenue lost had been reduced some and estimated around \$305 billion.

Hyman (2011) has stated that tax compliance study for the income tax. He suggests that some effective ways to decrease tax evasion, including the increase of both the probability of IRS tax audits for taxpayers and the requirements for reporting income to the IRS as well as the withholding taxes from earnings. However, beginning in 1963 and continuing every 3 years until 1988, the IRS analyzed 45,000 to 55,000 randomly selected households for a detailed audit as part of the Taxpayer Compliance Measurement Program (TCMP) in an attempt to measure unreported income and the "tax gap" (Andreoni, Erard, Feinstein, 1998). The program was discontinued in part due to its intrusiveness, but its estimates continued to be used as assumptions. In 2001, a modified random-sampling initiative called the National Research Program was used to sample 46,000 individual taxpayers and the IRS released updated estimates of the tax gap in 2005 and 2006 (Slemrod, 2007).

However, critics point out numerous problems with the tax gap measure. The IRS direct audit measures of noncompliance are augmented by indirect measurement methods, most prominently currency ratio models (Feige, 1989). The Internal Revenue Service (2012) released a new set of tax gap estimates for tax year 2006. The voluntary compliance rate — the percentage of total tax revenues paid on a timely basis for tax year 2006 is estimated to be 83.1 percent. The voluntary compliance rate for 2006 is statistically unchanged from the most recent prior estimate of 83.7 percent calculated for tax year 2001.

Also the current filing deadlines do not permit the IRS and taxpayers to access third-party information on a timely basis. Taxpayers' filing detail tax data for such as tax filing status, deductions, exemption number, taxable income, tax rate and tax, which are not covered by W-2 form, are known after the IRS receives their tax returns by April 15. Before receiving tax returns, the IRS has no detail individual tax data as references to be ready for comparisons. As a result, the current tax systems limit taxpayers' information to file accurate and timely returns. Then the IRS has no enough time to do verification on the taxpayers' returns before sending refunds to taxpayers, which give criminals a chance for possible tax evasion, such fraud created the cost of some \$5.2 billion for the IRS in 2013 (Shipley, 2015).

Kao and Lee (2013) have developed a linear and gradual (LG) tax system to simplify the current U.S. individual income taxation in 2011 and 2012. This study is to eliminate the current complex Tax Tables (12 pages) and Tax Rate Schedules without tax estimation by accurate tax rate and tax calculations. Kao and Lee (2014a) have further developed the LG tax system to simplify the current U.S. federal and state corporate income taxation in 2012 and 2013 from eight federal corporate tax brackets to four with 50% or more reduction. Kao and Lee (2014b) also have simply current state individual income systems practically. The advantages of the LG tax system include simplifications on tax/tax rate calculation, analysis, modification, reform, and projection with reductions of tax processing time and management cost for individuals, corporations, and governments.

This research paper is based on the LG tax system to simplify federal individual and corporate tax systems in 2013, 2014 and 2015. The proposed LG tax system combines the existing complex Tax Rate Schedules, Tax Table (12 pages) and Tax Computations together for employers and employees, designs computer programs to calculate tax rate and tax automatically, let the IRS to access taxpayers' information by January 15 for reducing tax theft crimes, and provides the possibility for many taxpayers with one income source to pay exact taxes from withholding taxes and have option on filing exemption for their tax returns. The LG tax simplification means to simplify tax rate/tax calculations, analysis, modification, reform and projection for Tax Administration without changing existing tax rates, which may be done by the IRS. The LG tax system simplified tax rates effectively according to actual situations for tax legislation.

Implications

Tax evasion costs billions of dollars to federal and state governments and taxpayers yearly. There are two major reasons. One is federal IRS and many state governments make two tax systems for employers to estimate withholding income taxes and for individuals to calculate accurate taxes in tax returns. The two tax systems are not connected each other. Employers and individuals have different standards or references even the two tax systems have similar tax rates. Then employers report W-2 forms, which do not include detail tax information such as tax filing status, exemption, deductions and taxable income, to the IRS by March 15. Another reason relates to timing problem. When receiving tax returns from individuals, the IRS and state governments have no detail tax information as references to compare and verify these tax returns and send tax refunds with 45 or even 15 days. The two major reasons give criminals a chance for possible tax evasion. The two problems can be overcome by the new LG tax system. The above two tax systems can be simplified and combined together. Also the IRS and state governments can receive detail 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 be ready for comparisons and verification. Then tax theft crimes would be reduced or avoided for individuals and governments.

1. Reasons to cause potential tax evasion by the existing tax systems

A. Existing two tax systems used by employers and individuals

In our existing federal tax system for individuals, there are 7 tax brackets with 10%, 15%, 25%, 28%, 33%, 35% and 39.6% with tax rates 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.

The IRS and many state governments make two tax systems currently. One is used for employers to estimate withholding income taxes with Tax Rate Schedules and related tables. 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 comparing 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 the difference \$30 (18,450-18,150).

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

Taxable income (TI)		2014 Tax is	of the mount over	Taxable income (TI)		2015 Tax is	of the mount over
Over	Not over			Over	Not 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%	148,850	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)

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

Another tax system, which includes Tax Tables and Tax Computations, is used for individuals to calculate accurate taxes in tax returns. Table 2 is the federal Tax Table and is used for individuals (such as Y 1: Married filing jointly), who have less than taxable income \$100,000, to search and find their tax payments. These tax payments in the 12-page Tax Table have no directed connection each other. The tax numbers in the Tax Table can be programmed by a tax software product with more data space and complex search function, which is used for automatic search. Table 3 shows Tax Computations in 2014, which has slight modifications comparing with 2013. For taxable incomes less than \$450,000, the differences between the two years are minor. 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. 2014 Tax Table and Tax Computations are slightly different from 2013. 2015 Tax Table and Tax Computations will be available by the IRS after January, 2016. Tax Schedules are used for estimating income taxes. Tax Table and Tax Computations are used for calculating accurate income taxes. Tax Schedules and Tax Table/Tax Computations have no direct relationship.

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

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

The two different tax systems make employers to use Tax Rate Schedules and individuals to use Tax Tables and Tax Computations. There is no direct connection between the two tax systems even they have similar tax rates. Before receiving tax returns, the IRS has no detail tax information such as filing status, exemption, deduction, retirement, credit, taxable income, tax rate and tax as references and do not know these tax returns are from real individuals or not because there is no reference to be compared, which may cause potential tax theft crimes. Many states have similar two tax systems such as CA, IA, 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 criminals for possible tax frauds. State governments face the same challenge of tax evasions.

B. 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. Some taxpayers require tax refunds and some taxpayers do not require tax refunds. There is significant work for the IRS and state governments to do specially for those tax returns, which require tax refunds. Employers report individual income information to governments with Form W-2 by March 15, which covers social security income, federal withholding income tax and state withholding income tax. There is no detail tax information such as filing status, exemption, deduction, credit, taxable income, tax rate and tax from Form W-2.

Verification and timing are two key issues. When the IRS and state governments have no tax information of filing status, exemption, deduction, credit, retirement and taxable income before receiving tax returns, then verification cannot be done by comparisons before sending out tax refunds, which give criminals a chance for possible tax theft crimes. Verification with comparison is needed before sending out tax refunds to reduce to avoid potential tax theft crimes.

There are about 79 million federal tax returns every year in the United States. All state tax return numbers may be some lower than 79 million because some states have no state tax. The IRS and state governments are very busy to process 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 income and gross income 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 complexity of the existing two federal tax systems with Tax Rate Schedules, Tax Tables, Tax Computations, changeable taxable income ranges and tax rates could be simplified and improved to let many taxpayers to have option to not file tax returns. The processing time and operating cost could then be reduced significantly. Then, the IRS and state governments can have more time to verify tax returns with comparisons.

2. The proposed LG Tax System for reducing or avoiding tax evasion

A. Combining and simplifying 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. 2011 and 2012 tax systems have been discussed with a linear and gradual (LG) tax system by Kao and Lee (2013 and 2014b). Tables 4 shows the LG tax system for 2014. The 7 tax brackets in the existing two tax systems are reduced to 4 with 43% reduction. Its taxable income ranges are simplified into such as 0-100,000-250,000-450,000 and over 450,000. All Tax Schedules and Tax Tables/Tax Computations can be replaced by Table 4 simply.

When individuals (Married Filing Jointly or Qualifying Widow(er)), have their 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, which is the 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).

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

Example 1: When a 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 the range check (10%-16.71%). Then $0.1 + 39,855.26/1,490,313 = 12.67\%$ is the tax rate (tax is \$5,056.84). When 2014 Tax Table (39,850-39,000) is used, the tax is \$5,074 and tax rate is at 12.72%. Their tax rate difference is 0.05%, which is very minor. The item $(39,850 - 39,000)/39,875$ causes tax rate difference 0.13%.

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

When the simple LG tax rate formulas in the Table 4 are used to replace Tax Tables (12 pages), the situations have been simplified and improved significantly. Their results are very compatible. Figure 1 shows tax rate differences between LG tax system and 2014 Tax Tables and Tax Computations. There are minor differences except low taxable incomes less than \$1,000. From the existing Tax Table, tax rates at low taxable incomes from \$5 to \$1,000, tax rates are 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%.

For different filing periods, employers may consider filing period factor (F) and government regulations and modify 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 ($\text{Tax rate} = a + TI/b$ or $c - d/TI$) may be modified and adjusted simply and practically. 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 of $y = a + x/b$ is suggested to be used for all taxable income ranges except last taxable income range. In $y = c - d/x$, tax rate slope relates to taxable income and always changes at d/x^2 , which are used in the existing U.S. federal systems and many other countries. For last taxable income range, $y = c - d/x$ is suggested.

Table 5 LG Tax Rates for Federal and state Individuals on Different Filing Periods

D (daily)	W (weekly)	BW (bi-weekly)	SM (semi-month)	M (month)	Q (quarter)	SY (semi-year)	Y (yearly)
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 comparisons. Employers use the LG tax system (Table 4) to calculate withholding income taxes and transfer to governments. When employees provide accurate tax information such as filing status, exemption number, retirement, deduction and credit, withholding income taxes will be also accurate. Especially employees have simple tax situations with stable income, fixed retirement, standard deduction and credit and less than social security income less than \$100,000, accurate income taxes are possibly calculated by employers. Then these employees may have option to let the IRS and state governments to know they would not file tax returns because there is no difference between withholding income taxes and taxes in tax returns. Less tax return numbers can reduce work for governments to process necessary tax returns during the tax season, which is helpful for governments to verify more tax returns and reduce potential tax evasions.

B. Tax refunds, timing and verification

Employers estimate income taxes according to different filing periods. Yearly withholding tax reports can be done and reported to the IRS and state governments by Jan 15 or 31. The tax report summary for each employee can have tax information of name, social security number, filing status, exemption number, retirement, deduction, credit, taxable income, tax rate, tax and address. Taxpayer’s filing status, exemption number, retirement, deduction, credit, gross income, taxable income, tax rate and tax could be used for detail comparison and verification, which can be done automatically, when to the IRS and state governments receive tax returns. Filing status, exemption number, deduction, credit and taxable income, tax rate and tax are not covered in Form W-2. If there is unmatched item or large difference such as taxable income difference more than \$2,000 or tax rate difference more than 10%, tax refunds can be hold for further inspection, which reduce or avoid potential tax frauds.

From timing issue, the tax report summary can go to the IRS and state governments electronically by Jan 15 or Feb 15 with modifications. Some individuals, who meet certain conditions such as gross income less than \$100,000, interest/capital gain less than \$2,000 and tax difference less than \$200, may have option to not file tax returns. Some employees may modify their tax information through their employers electronically by Feb 10. Then the IRS and state governments have all employees’ tax information of filing status, exemption number, retirement, deduction, credit, gross income, taxable income, tax rate and tax by Feb 15. Before receiving tax returns by April 15, the IRS and state governments already have tax information ready and enough time to verify tax returns for all employees. If employees change tax information (except deduction, retirement, credit and income) between their employers’ reports and tax returns, their tax refunds may be postponed reasonably because of the significant changes, which need extra verifications. The LG tax system could help the IRS (and State governments) to reduce or avoid potential tax evasions.

Rrelated computer programs to calculate taxable income, tax rate, and tax amount automatically have been developed for the LG federal individual tax system in 2012, 2013, 2014 and 2015 and 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, exemption, retirement, deduction, credit and withholding income tax are inputted, the computer programs recognize the tax filing status, pick up

related LG tax rate formula and calculate taxable income, tax rate, tax refund or tax due automatically. A tax rate range check is provided to check its tax rate calculation, which must be within the narrow tax rate range check to reduce calculation mistakes.

C. Tax return option on filing exemption for reducing tax evasions

About 79 million federal individual tax returns are filed in the U.S. each year. 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 exam and collection cost in 2011 is \$4.7 billion (www.irs.gov/pub/newsroom/budget-in-brief-2012.pdf). The simple linear and gradual (LG) tax system provides a good tool for governments, employers and individuals to calculate accurate taxes yearly, which may help many taxpayers with non-complex tax situations such as one income source, less than \$100,000 income and unchangeable filing status and exemption number to have no (or almost no) difference between withholding income taxes and tax returns. So many taxpayers may have option to not file tax returns. If 30% tax returns are reduced, billions of dollars can be saved, which also can reduce potential tax evasions.

Example 2: A mother as Head of Household with two dependents (under 17) has one-income source at \$75,000 yearly. She claims standard deductions. Her employer deducts related tax payments (including withholding income tax) for every two weeks and that 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, health deduction and credit. Her retirement is \$300 bi-weekly. Each child has tax credit \$1,000. Tax data may be calculated by a computer software product automatically.

$$\text{Taxable income (TI)} = \text{Income (I)} - \text{Standard Deductions (SD)} - \text{Exemption (E)} - \text{Other Deductions (OD)} \dots\dots\dots (2)$$

$$1) \text{ Gross Income (two weeks): } 75,000/26 = 2,884.62$$

$$\text{Taxable income} = 75,000 - 9,100 - 3,950 \times 3 - 300 \times 26 = \$46,250$$

$$\text{TI (2 weeks)} = 2,884.62 - (9,100 + 3,950 \times 3)/26 - 300 = 1,778.85$$

$$\text{Tax rate} = 0.1 + \text{TI}/1,062,699.3 (2/1) = 0.1 + 46,250/1,062,699.3 = 14.35\% \dots\dots\dots (3)$$

$$\text{Income tax (two weeks)} = \text{Tax rate} \times 1,778.85 - 1000 \times 2 / 26 = \$178.38$$

2) There is an additional payment with \$2,500 (bonus or salary raise) in December:

$$\text{Final tax rate} = 0.1 + \text{TI}/1,052,631.6 (2/1) = 0.1 + (46,250 + 2,500)/1,062,699.3 = 14.59\% \dots\dots\dots (4)$$

$$\text{Total income tax} = \text{Final tax rate} \times 48,750 - 2000 = \$5,111.35 \dots\dots\dots (5)$$

$$\text{Last income tax payment} = 5,111.35 - 178.38 \times 25 = \$651.85 \dots\dots\dots (6)$$

The IRS may have her tax records as Head of household with two children, one-income source \$75,000 yearly, Standard Deduction \$9,100, 3 exemptions, retirement \$7,800, child credit \$2,000, taxable income \$48,750 and total withholding income taxes \$5,111.35 at yearly tax rate of 14.59% from her employer’s tax summary reported by Jan 15 or 31. She may have an option to not file tax return if she has her total interest and capital gain less than such as \$2,000.

Example 3: When a man, who files as Married couple with two children, works and lives in California and has a one-source annual based income of \$95,000 from his company. His employer may use our tax software product to deduct related

withholding taxes and credits on a bi-weekly and yearly 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 and exemption credit of \$212 for Married Filing Jointly and dependent exemption credit of \$326. He has one child credit for federal tax return. His retirement is at \$146.15 biweekly and medical insurance is at \$153.85 biweekly.

His employer calculates his initial federal income tax rate is at 13.96% and income tax (bi-weeks) is \$278.30. His withholding taxes (bi-weeks) including withholding income tax, Social Security and Medicare from both employee and his employer, are \$837.34 to the federal government. His initial California income tax rate is at 3.13% and income tax (bi-weeks) is \$53.59 to 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 yearly overall federal income tax rate is at 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 employee and his employer, are \$23,279.14 to the federal government. His total federal income tax is \$8,055.64. His yearly overall California income tax rate is at 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 is \$6,180.84 in the December. His yearly total federal taxable income is \$63,500. His yearly total payroll is \$82,241.88. These calculated numbers are shown by the tax software product automatically.

The IRS may have his tax records of Married Filing Jointly with two dependents, one-income source \$95,000 yearly, Standard Deduction \$12,400, retirement \$3799.90 and 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, exemption, deduction, 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 ignored, and use above federal and state deductions and tax credits, the family has income taxes as 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 not file the federal and state tax returns if total interest and capital gain is less than such as \$2000.

If he reports the above bank saving interest of \$225.87 to his employer or the IRS and adds it as his income, the family needs to pay total federal income tax of \$8,097.51 with the difference of \$41.87 and total state tax of \$1,600.82 with the 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 worth to file their federal and state tax returns by paying an extra \$41.87 to the federal government and \$10.09 to his state government, which involve more tax processing costs and time to the governments. This case has been discussed in 2015 AEF Conference by Kao and Lee. If bank interest and investment capital gain are less than \$2000 and federal tax difference less than \$200 between income withholding tax and calculated tax in the federal tax return, it may be suggested to offer these taxpayers to have an option to not file the federal tax returns, which reduce tax return numbers for saving tax processing time and costs and reducing potential tax theft crimes.

Conclusion

The two major reasons to cause potential tax evasions are discussed in the paper. One is the IRS and many state governments make two tax systems for employers and individuals separately. Tax Schedules are used to estimate withholding income taxes. Tax Tables and Tax Computations are used for individuals to calculate their tax returns. The two tax systems are not connected each other. Employers and individuals have different standards or references even the two tax systems have similar tax rates. Another reason relates to timing problem. Detail tax information such as tax filing status, exemption, deductions, taxable income, overall tax rate and tax 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 detail tax information as references to compare and verify these tax returns. The two major reasons would give a chance of fraud for a possible tax evasion.

The two federal individual tax systems with Tax Schedules and Tax Tables/Tax Computations have been recognized and combined together simply. Then governments, employers, and individuals can use the same LG tax system as standard and common reference. Employers can report tax summary with detail tax information such as tax filing status, exemption, deductions, taxable income, tax rate and tax, which is not covered in W-2 Form by March 15, to the IRS and state governments by Jan 15 or Feb 15 with modifications. Before receiving tax returns by Feb 15 - April 15, the IRS and state governments already have tax information ready 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.

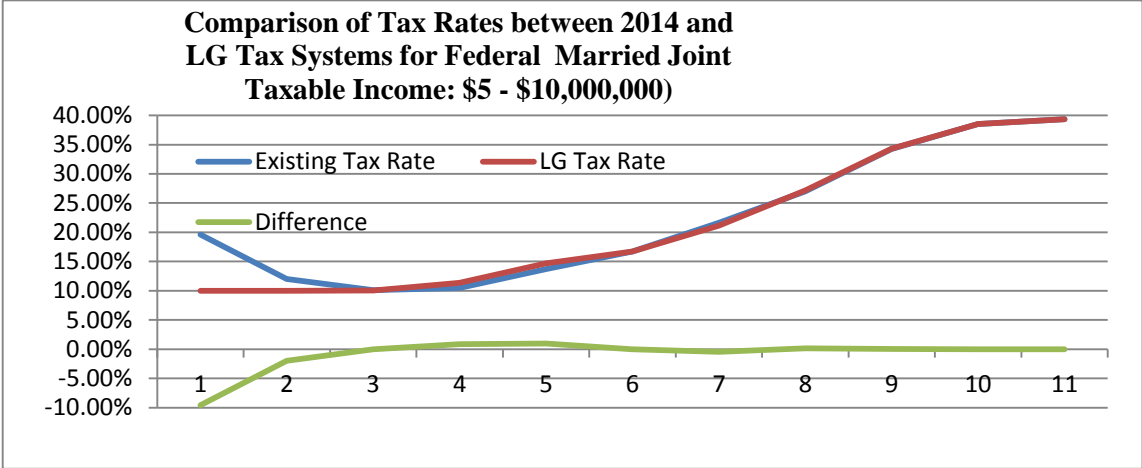
The related computer programs to calculate taxable income, tax rate and tax automatically have been developed according to tax filing status, gross income, exemption, retirement, deduction, credit, and withholding income tax. The computer programs recognize the tax filing status, pick up related LG tax rate formula and calculate taxable income, tax rate, tax refund or tax due automatically.

There are about 79 million federal tax returns per year. The average cost of estimated average taxpayer burden for individuals is about \$210 by the IRS. If 20% of tax returns are exempted from filing out of total 7.9 million, the substantial amount of \$3.3 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 evasions could also be reduced.

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Figure 1 Existing Federal Individual Tax System and LG Tax System



(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.)