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The Merits of Establishing a Business Information Returns Program

Statement of
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Before the
Subcommittee on Commerce, Consumer and Monetary Affairs
Committee on Government Operations
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here this morning to assist the Subcommittee in determining whether business taxpayers are underreporting income received from third parties or not filing tax returns, and whether an Information Returns Program for such business income is feasible. In response to your May 1986 request, we matched samples of business information returns and associated business tax returns and, with IRS cooperation, followed up on a selected number of potential business underreporters. We also examined the validity of several factors which the Internal Revenue Service (IRS) identified as impediments to conducting a business information returns program similar to the one used for individual taxpayers.

Because IRS' Information Returns Program for individual taxpayers has become an important enforcement tool, and because IRS' latest estimates show business noncompliance increasing, some level of matching of business information returns should be considered. Our work showed that some businesses had underreported their interest and dividend income or had not filed tax returns. We concluded that business information returns can be used to identify such businesses. With existing systems, IRS could begin now to use information returns to identify potential nonfilers and some sole proprietorships that potentially underreport income.

For a full-scale effort, IRS would have to design a program to overcome several impediments. Alternatives exists to overcome these impediments, but they may take time to fully implement and may involve additional costs to IRS, businesses, and third-party payers. Therefore, IRS would have to consider the benefits, costs, administrative burdens, and feasibility associated with implementing any alternatives and developing a full-scale business information returns program. Also, a legislative change would be needed to require information return reporting for corporations.

INDIVIDUAL INFORMATION RETURNS PROGRAM

IRS' experience with the individual Information Returns Program can be used for developing a business information returns program. Information returns are the documents that third-party payers, such as employers, corporations, and financial institutions, submit to IRS on certain payments made: (1) to taxpayers for wages, dividends, interest, and other types of income; and (2) by taxpayers that are deductible from income, such as mortgage interest. Third-party income, such as interest and dividends, is reported on the Form 1099 series of information returns. Information returns provide the payees' names, amounts paid, types of income, and taxpayer identification numbers--which are the social security numbers for individuals. This information is submitted to IRS primarily on magnetic media, but some paper information returns are still submitted.

IRS' Information Returns Program for individuals computer matches information returns with associated tax returns to identify potential underreporters and nonfilers. If the income or deductions reported on the information returns are not the same as those reported on the tax return, and if there is potential for additional tax, a potential underreporter case exists. If the process determines that too much tax was paid, a potential overreporter case exists. If the information returns cannot be associated with a tax return, a potential nonfiler case exists.

IRS attempts to select the most productive potential underreporter and nonfiler cases for follow-up. This usually consists of a detailed screening of the case and possibly sending a notice to the taxpayer requesting him or her to explain the discrepancy, file a return, or pay the additional tax owed.

IRS considers this individual Information Returns Program to be an extremely important enforcement tool and recently has requested more resources for the program so it can follow up on more potential underreporter and nonfiler cases. According to IRS, this program generated $2.4 billion in 1982 tax assessments (the latest year for which assessment totals were available) at a 17 to 1 yield/cost ratio.

SOME BUSINESSES ARE NOT REPORTING ALL THEIR INTEREST AND DIVIDEND INCOME

Each year, businesses--corporations, partnerships and sole proprietorships--earn billions of dollars in third-party income, such as interest and dividends. IRS data show that corporations reported about $495 billion in interest alone on their 1983 tax returns. Individuals reported $154 billion of such income for that year.

IRS receives millions of business information returns each year but does not match them to business tax returns. For calendar year 1983, we identified about 11.4 million information returns that IRS had received.

Using these tax year 1983 business information returns, we randomly selected and analyzed 1,679 business tax returns from a universe of 811,977 businesses for which information returns were submitted (644,928 corporations[1], 135,173 partnerships, and 31,876 sole proprietorships) to identify potential underreporters. Our initial screening disclosed that 559, or about 33 percent, of these businesses may have underreported interest and dividend income and were worthy of additional review. We project that if the universe of business tax returns in our sample were subjected to this initial screening process, it would identify 316,577 businesses as potential underreporters involving about $1.0 billion or about 13 percent of the $7.7 billion in interest and dividends that should have been reported (see table I.1, app. I). As discussed below, the number os potential underreporters identified in any initial screening would be reduced as a result of IRS' contact with the taxpayers. Appendix I of this

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[1]Although information reporting for corporations was not required in 1983, IRS still received business information returns for many corporations.

statement provides more detailed information on the methodology used for the samples in our study.

Recognizing that many of the 559 potential underreporters may have had legitimate reasons for not reporting the income on these 1983 tax returns, we asked IRS to do a limited follow-up with them. This follow-up consisted of one letter to the taxpayer and one follow-up telephone call, if necessary. IRS did not attempt to verify the taxpayer's explanation of the potential underreporting. Assignment timeframes prohibited IRS from corresponding with all 559 businesses initially identified as potential underreporters, but IRS corresponded with 181 of them. IRS' follow-up resulted in our classifying 54, or about 30 percent, of the 181 businesses contacted as not reporting all of the interest and dividends they received (see table II.1, app. II). These 54 businesses may have underreported $302,102, or about 22 percent of the $1,372,823 income that should have been reported.

We believe that the 30 percent underreporter rate associated with the 181 cases IRS followed up on may be understated because our analysis included pension plan and nominee-type information returns which would not be part of a business information returns program. Pension plan income is deferred income and nominee income is income received by an intermediary and passed on to another party. (An example of nominee income is the interest income earned by a lawyer who is acting as an executor of a will until probate action is completed on the estate.) This income is not reported on a business' income tax return and, therefore, would not be included as part of any document matching program. Due to data limitations, we were unable to initially screen these returns from our sample. Eliminating the 46 pension and nominee cases from our analysis of the 181 businesses would increase the rate of underreporters from about 30 percent to 40 percent, and the percent of information return income that was not reported from 22 percent to 36 percent.

In the individual Information Returns Program, IRS computer-matches information returns to tax returns and reviews those returns where the amount of potential underreporting is significant. To simulate such an approach, we analyzed a second sample of 955 businesses (465 corporations and 490 partnerships) from a universe of 26,743 businesses that were identified in the initial screening as potentially underreporting at least $1,000 in interest or dividends. After reviewing the tax returns, we found that 787 of the 955 businesses may have underreported about $234 million or 83 percent of the $282 million of the interest and dividends shown on the information returns. We project that if this universe of business tax returns were subjected to this screening process, it would identify 22,059 businesses as potential underreporters involving $1.0 billion of the $1.3 billion in interest and dividends that should have been reported (see table I.2, app. I).

Again, because there may have been legitimate reasons for not reporting this income, we asked IRS to do a limited follow-up with 557 of the 787 businesses. (Due to assignment timeframes, IRS could not follow up on all cases.) As a result of IRS' follow-up, we classified 110 or about 20 percent of the 557 businesses as not reporting all the interest and dividend income they should have (see table II.1, app. II). These 110 businesses may have underreported about $4.2 million or 10 percent of the $44.2 million income that should have been reported. There were 298 cases where the businesses said that the income in question was for their pension plans or was nominee income. Eliminating these 298 cases from the 557 cases increased the underreporter rate from 20 percent to 42 percent and the percent of information returns income that was not reported from 10 percent to 20 percent. Details of IRS' correspondence with and our classification of the 181 and 557 taxpayers in the above samples (a total of 738 taxpayers) can be found in appendix II of this statement.

SOME BUSINESSES DID NOT
FILE TAX RETURNS

To determine whether businesses are filing tax returns, we sampled 2,648 of the 769,196 business taxpayers for which IRS received calendar year 1983 information returns but for which IRS' records did not show tax year 1983 tax returns. We analyzed various IRS records and found that 496 of the 2,648 business taxpayers were apparently required to, but did not, file either a corporation, partnership, estate, or trust tax return for tax year 1983 (see table I.3, app. I). Because of assignment timeframes, we were unable to complete our analysis of potential sole proprietorship nonfilers.

IRS' business nonfiler program, which primarily consists of following up on businesses that file returns one year but not the next, did not identify 401 of the 496 potential nonfilers we identified by using information returns. Because these taxpayers had either filed a final tax return the previous year, or not filed tax returns for 2 or more years, or never filed tax returns, they were not identified by IRS' business nonfiler program. Had IRS used the information returns, they could have identified these potential nonfilers for possible follow-up action.

Through its current nonfiler program, IRS had identified the remaining 95 of the 496 potential nonfilers we found. For the most part, IRS had closed these 95 nonfiler cases without securing tax returns because IRS concluded the taxpayers were not liable to file returns, owed little or no tax, or could not be located. Because the information return data indicated that the businesses received income, they would have been useful to IRS in determining the taxpayers' need to file tax returns. Because of assignment timeframes, we did not ask IRS to follow up on any of the potential nonfilers we identified. However, if IRS were to contact them, the number of potential nonfilers would likely be reduced.

IMPEDIMENTS TO DEVELOPING A BUSINESS INFORMATION RETURNS PROGRAM

There are potential benefits to using information returns for identifying potential business underreporters and nonfilers. However, IRS would have to address various impediments if a full-scale business information returns program were to be developed to identify business underreporting. For example, a study IRS completed in 1981 identified several impediments to developing a business information returns program. First, many businesses file tax returns on a fiscal year basis, while information returns are issued on a calendar year basis. Second, many businesses use the accrual method of accounting while information returns reflect payments on a cash basis. Third, the business names on some information returns are not always identical to the names on IRS' master file. Fourth, information returns are received on subsidiaries that may file as a part of consolidated returns.

In addition to the above, we identified two other impediments that must be addressed to have a full-scale business information returns program. First, IRS does not receive all the information returns on corporations that would be needed for a full-scale business information returns matching program. Second, information returns do not readily distinguish between the businesses' employee pension plan income and other third-party income received by businesses, or between nominee income and income directly received by the payee. These impediments, and those identified by IRS, should not substantially affect IRS' ability to use information returns to detect business nonfilers.

We have identified various alternatives that could be considered for addressing these impediments, and other alternatives may also exist. These alternatives may take time to fully implement and may involve added cost to IRS, businesses, and third-party payers. We recently issued a report, COMPUTER MATCHING: Assessing Its Costs and Benefits (GAO/PEMD-87-2, Nov. 10, 1986), which identifies computer matching cost and benefit elements that could be considered in developing a computer matching program. This report should be helpful to IRS in analyzing the costs and benefits of a business information returns program.

Fiscal year returns

Matching calendar year information returns to fiscal year tax returns could complicate the identification of underreported income. However, this impediment does not exist for all businesses. According to IRS, about 61 percent of the 3 million corporations, 4 percent of the 1.5 million partnerships, and less than 1 percent of the 10.7 million sole proprietorships filed on a fiscal year basis in 1983. Thus, fiscal year tax returns should not hinder IRS from using information returns to detect unreported income for 96 percent of the partnerships and almost all of the sole proprietorships. Even with regard to corporations, fiscal year filing is not a problem for 39 percent. IRS data show that these corporations have about 79 percent of the total assets, 65 percent of the net income, and 60 percent of the total receipts reported by all corporations. Also, as a result of the recent tax reform legislation, about 500,000 fiscal year filers may have to file on a calendar year basis.

To include fiscal year filers in a matching program, IRS could consider (1) having payers submit information returns on a fiscal year basis or (2) having payers submit monthly income statements which would allow IRS to associate monthly earnings to the business taxpayer's fiscal year. These two alternatives may require legislative changes. Also IRS could consider having fiscal year taxpayers reconcile the interest and dividend income reported on their fiscal year tax returns with the income reported on calendar year information returns.

Accrual method of accounting

Under the accrual method of accounting, all items of income are included in gross income when actually earned, rather than when payments are received. Under the cash method of accounting, all items of income are included in gross income when payments are received. The accrual method becomes a problem for document matching purposes when the business accrues income on its books in one year that is received in a different year. In one year a business may accrue and report more income on its tax return than the amount shown on the information returns--suggesting an overreporter case. In a subsequent year, however, the business might report less income than that shown on the information returns--generating a false underreporter case.

The accrual method of accounting problem affects more businesses than the fiscal year filing problem. IRS estimates that about 62 percent of corporations, 26 percent of partnerships, and less than 4 percent of sole proprietorships use the accrual method of accounting for tax purposes. The other businesses use the cash method of accounting or a combination of the cash and accrual methods.

To overcome the timing difference between information returns and the accrual accounting method, IRS could consider having businesses complete a reconciliation schedule similar to that previously proposed for fiscal year filers.

Names on information returns

According to IRS officials, some payers submit information returns with business names that are not identical to the business names contained on IRS' master files. For example, IRS may receive a partnership information return under the name "Smith, Jones, and Black," yet IRS records list the partnership as "Black, Smith, and Jones." As a result, an exact entity match (name and employee identification number) cannot be made.

We do not believe that this name problem should be a deterrent to a document matching program. The key to document matching is the employer identification number, and Internal Revenue Code section 6109 requires payers to have correct employer identification numbers on information returns they submit to IRS. Consequently, the name of the business is not critical to the match. In addition, IRS could instruct taxpayers to ensure that the names on their third-party income accounts correspond to the names used on their tax returns.

<u>Subsidiaries may report income on consolidated returns</u>

Another matching problem involves subsidiary corporations that receive third-party income under the subsidiary name but report the income on the parent corporation's tax return. IRS does not have a computerized cross reference file that associates the names and employer identification numbers of subsidiaries to parent corporations. Therefore, the information returns on subsidiaries cannot be readily associated with tax returns filed under a parent's name and employer identification number.

To overcome this impediment, IRS could consider developing a cross reference file between parent and subsidiary corporations. IRS already has the information necessary to create this cross reference file. As another alternative, IRS could consider requiring subsidiary corporations to use the parent's employer identification number on third-party accounts. The parent employer identification number would then be used by payers on subsidiary information returns sent to IRS.

<u>Information returns reporting for corporations</u>

IRS does not receive all the information returns on corporations that it would need to have a full-scale business information returns program. Sections 6049 and 6042 of the Internal Revenue Code require payers of interest and dividends to file information returns with IRS for payments made to partnerships and sole proprietorships. The Code does not require information return reporting on interest and dividend payments made to corporations. Thus, a legislative change would be needed to require such reporting.

Before 1982, payers were required to submit to IRS information returns on interest and dividends earned by corporations. Section 301 of the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248) exempted corporations from the mandatory withholding requirements of the act and exempted third-party payers from information reporting on interest and dividend income earned by corporations. The information reporting exemption was granted to reduce the overall reporting burden placed on third-party payers as a result of mandatory withholding.

Subsequently, the Interest and Dividend Tax Compliance Act of 1983 (Public Law 98-67) repealed the mandatory withholding requirements for noncorporate taxpayers. However, this Act did not restore the information reporting requirements on corporations that had been in effect prior to the Tax Equity and Fiscal Responsibility Act of 1982. As a result, third-party payers are still exempt from information reporting on payments of interest and dividends made to corporations.

Information returns for pension plan and nominee income

During our analysis, we noted that information returns for pension plans and nominee income would be a problem in developing a business information returns program. Pension plan and nominee income are not reported on business income tax returns and consequently would not be a part of any document match. Currently, these information returns cannot be easily identified and screened. If not screened from the match, they would produce false underreporter leads.

We found that 289, or about 39 percent, of the 738 potential business underreporters that IRS corresponded with said that the interest and dividends in question were for their pension plans and were properly reported on pension plan returns (see table II.1, app. II). About 95 percent of the businesses that said the income was for their pension plans were corporations. As for nominee income, 55, or about 7 percent, of the 738 businesses contacted by IRS said they were nominees and they were not required to report the income on their tax returns.

A possible way to screen these information returns would be to have payers code information returns to identify the income as pension and nominee income. Currently, payers must enter a one-digit code on the information returns they submit to IRS to identify the types of taxpayer identification numbers the payees have. IRS could consider requiring payers to use such codes to designate whether accounts are for pension plans or other purposes.

TAX FORM AND COMPUTER FILE CHANGES

To have a full-scale business information returns program, IRS would also need to revise certain tax forms to allow specific data on information returns to be associated with information reported on tax returns. For example, like the Form 1040 individual income tax form, Form 1120, U.S. Corporation Income Tax Return, has separate lines for reporting total interest and dividends received, and these amounts can be matched with the information returns to identify aggregate unreported income. However, unlike Schedule B, which is completed by individual taxpayers, business forms do not require an itemized listing of third-party income by payer. Consequently, IRS cannot inform the taxpayer of the exact interest and dividend sources that were not reported.

As a second example, Form 1065, U.S. Partnership Return of Income, has one line that covers both taxable interest and dividends. Form 1065 could be revised to have separate lines for interest and dividends and require, as for corporations, a schedule listing the sources and amounts of partnership interest and dividend income.

IRS also needs to associate third-party income received by sole proprietorships under their employer identification numbers with their individual income tax returns. Such businesses can receive interest and dividend income either under the owner's social security number, which could be reported on the individual's Schedule B, or under the employer identification number, which could be reported on the individual's Schedule C or F.

IRS has the capability to use some information returns it receives on sole proprietorships to identify potential underreporting. For example, IRS could match the employer identification number on the information returns with the employer identification number on the Schedule C or F. Then, IRS could consolidate the business information returns with those that were filed under the taxpayer's social security number and match the total amount with the amount shown on Form 1040. If these amounts are not the same, a potential underreporter case would be generated.

However, IRS cannot match business information returns when the taxpayer omits the employer identification number on Schedule C or F, or fails to file Schedule C or F. IRS is currently studying the merits of creating a cross reference file to relate sole proprietorships' employer identification number to the social security numbers of the related individual income tax returns.

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This concludes my prepared statement. We would be pleased to respond to your questions.

SAMPLING METHODOLOGY AND STATISTICAL PROJECTIONS

Our sampling plans were designed to provide statistically valid projections of the number of potential tax year 1983 business underreporters and their associated unreported interest and dividends, which could be detected through using information returns. Our underreporter projections can be made only to the universe of businesses for which IRS received information returns and not to the total business universe.

To identify potential nonfilers we took a random sample of taxpayer entities that did not file corporation, partnership, or sole proprietorship tax returns. We did not project the nonfiler sample.

Details on our sampling methodology, sample case analysis, and the reliability of our projections are discussed below.

UNIVERSE OF BUSINESSES SAMPLED

Our samples were based on a universe of 11.4 million calendar year 1983 business information returns submitted by payers to IRS. The returns contained employer identification numbers for 2,172,409 taxpayer entities. To determine the number of corporations, partnerships, and sole proprietorships associated with the information returns, IRS matched the information returns to its tax year 1983 business and individual master files. This match identified the universe of businesses that we sampled to determine potential business underreporters. The universe consisted of (1) 956,846 corporations that filed Form 1120 tax returns; (2) 198,491 partnerships that filed Form 1065 tax returns; and (3) 105,084 sole proprietorships that filed either schedules C or F with their Form 1040 individual tax returns. In addition to these 1,260,421 business entities, the match also identified 142,792 corporations that filed other types of Form 1120 tax returns, such as Subchapter S corporations filing a Form 1120S. We did not sample these other types of Form 1120 returns for unreported income.

There were 769,196 taxpayer entities remaining after we determined the number of corporations, partnerships, and sole proprietorships that filed tax year 1983 tax returns. These remaining taxpayer entities represented the universe from which we sampled to determine potential nonfilers.

BUSINESS UNDERREPORTER

SAMPLE PLAN

To estimate the number of businesses that may have underreported their interest and dividend income, we randomly selected 1,000 tax year 1983 tax returns for each of the three types of businesses. These businesses were selected from the universe of

956,846 corporations, 198,491 partnerships, and 105,084 sole proprietorships for which information returns were submitted to IRS. This sample was taken without regard to the types of information return income associated with these tax returns or the amount of income reported on the tax returns. We then manually screened out the cases that did not have information returns on interest or dividend income.

In its individual Information Returns Program, IRS concentrates its efforts on those cases where a match showed that the amount of unreported income was significant. To simulate this approach, we identified the 16,623 corporations and 14,589 partnerships in the total universe where the interest or dividend amounts on the information returns were over $1,000 more than the businesses reported on their tax returns. We then selected random stratified samples of 600 tax year 1983 returns for both corporations and partnerships.

Underreporter Sample

Case Analysis

For those cases in both samples for which we were able to obtain tax returns, we manually compared the amounts of interest and dividends the businesses reported on their tax returns to the amounts reported on the information returns to determine if the income was reported somewhere on the tax returns. For those businesses that filed on a fiscal year basis, we reviewed both of the fiscal year returns that covered calendar year 1983. If the total income reported on the combined fiscal year tax returns exceeded the amounts on the information returns, these cases were not classified as underreporters. If the information return amounts exceeded the total amounts on the two fiscal year returns, the cases were classified as potential underreporters. We consulted with IRS in our review and analysis of tax returns.

Underreporter Sample Projections and Confidence Levels

Our sample of the universe of businesses for which we had information returns was designed to produce projections of the potential number and dollar amounts for which the businesses did not fully report their interest and dividend income. Before we made our projections, we adjusted our universe to account for cases that did not have information return income on interest and dividends and for cases where we did not obtain tax returns. Table I.1 shows the results of these adjustments and projections.

Table I.1:
Projected Potential Underreporter Cases And Amount of Unreported Income[a]
(Dollars in thousands)

	Corporations	Partnerships[b]	Sole proprietorships	Total
Projected potential underreporter cases				
Universe size	644,928	135,173	31,876	811,977
Number of potential underreporters	273,518	31,932	11,127	316,577
Sampling error cases[c]	±24,104	±4,276	±1,665	
Percent of universe size	42.4	23.6	34.9	39.0
Potential unreported interest and dividend income				
Universe amount	±$6,957,785	±$ 700,722	$39,999	$7,698,556
Potential amount unreported	$ 943,090	$ 65,306	$ 7,749	$1,016,145
Sampling error amount[c]	±$ 281,607	±$ 40,030	±$ 3,075	
Percent of universe amount	13.6	9.3	19.4	13.2

Source: GAO

[a]The number of potential underreporters and the potential unreported income amounts shown in this table would be reduced as a result of further screening by IRS and contact with the taxpayers.

[b]Sample projected to the universe of cases that had potential underreporting of less than $100,000.

[c]Sampling errors shown are at a 95 percent confidence level.

We made similar projections for the stratified sample of businesses where the information return amounts exceeded the amount of interest and dividends the businesses reported on their tax returns by $1,000 or more. Before we made our projections, we adjusted our universe to account for cases where we did not obtain tax returns. Table I.2 shows the results of these adjustments and projections.

Table I.2
Projected Potential Underreporter Sample Cases And Unreported Income Amounts For Cases over $1,000[a]
(Dollars in thousands)

	Corporations	Partnerships	Total
Projected potential underreporter cases			
Universe size	13,779	12,964	26,743
Number of potential underreporters	13,202	8,857	22,059
Sampling error cases[b]	±242	±541	
Percent of universe	95.8	68.3	82.5
Projected potential unreported interest and dividend income			
Universe amount	$559,497	$737,908	$1,297,405
Potential amount unreported	$428,997	$601,265	$1,030,262
Sampling error amount[b]	±$ 69,428	±$380,113	
Percent of universe amount	76.7	81.5	79.4

Source: GAO

[a]The number of potential underreporters and the potential unreported income amounts shown in this table would be reduced as a result of further screening by IRS and contact with the taxpayers.

[b]Sampling errors shown are at a 95 percent confidence level.

BUSINESS NONFILER SAMPLE

We selected a random stratified sample of 2,648 taxpayer entities from the 769,196 entities that received calendar year 1983 information returns and had not filed corporation, partnership, or sole proprietorship tax returns. The sample was divided into three strata by the income amounts on the information returns. The strata were $1 to $999, $1,000 to $99,999, and $100,000 or more.

We analyzed each of the sampled entities to determine if they were required to but did not file an income tax return. First, we categorized the sampled entities by type--corporations, partnerships, estates, and trusts. Then, on the basis of the information return data that showed the sampled entity was operating in calendar year 1983 and the amount of income it received, we established or verified the entity's income tax return filing liability.

We then reviewed IRS' Business Master File, Employee Plan Master File, and Non-master File records to determine whether the entity filed its required income tax return or filed some other type return, such as a pension plan, on which the taxpayer could have reported the information return income. We considered the sampled entities as potential nonfilers if they did not file a tax return by September 1985, which according to IRS officials, would have been the date it would have completed a tax year 1983 business matching program. We had IRS Collection officials review our nonfiler cases and confirm our findings. We also determined whether IRS had previously identified the entity as a tax year 1983 nonfiler. The following table shows the results of our case analysis.

Table I.3:
Potential Nonfiler Sample Cases[a]

		Nonfilers identified by IRS		Nonfilers missed by IRS		Total nonfilers	
	Number sampled	Number	Weighted percent[b]	Number	Weighted percent[b]	Number	Weighted percent[b]
Corporations	1,094	75	9.5	156	20.1	231	29.6
Partnerships	165	9	5.5	120	71.5	129	77.0
Trusts	1,148	10	0.9	107	8.8	117	9.7
Estates	214	1	0.5	18	8.6	19	9.1
Total	2,648	95		401		496	

Source: GAO

[a]The number of potential nonfilers shown in this table would likely be reduced as a result of further screening by IRS and contact with the taxpayers.

[b]Weighted to reflect sample stratification.

RESULTS OF IRS FOLLOW-UP OF 738 POTENTIAL BUSINESS UNDERREPORTERS

Once we identified the potential underreporters from our two samples, we asked IRS to question some of these taxpayers on whether the interest or dividend income was properly reported. IRS officials reviewed the cases which primarily consisted of those taxpayers who potentially underreported about $500 or more, and then attempted to contact the taxpayers. The contact was limited to one letter and one telephone call, if necessary. For the sample, IRS' objective was to obtain the taxpayer's explanation of the apparent underreporting only. In the individual Information Returns Program, IRS' action would not necessarily stop at this point. Due to assignment timeframes, IRS corresponded with only 738--181 from the first sample and 557 from the second sample--of the 1,346 potential underreporters we identified in both samples.

IRS furnished us the results of these taxpayer contacts. In addition to those who admitted they underreported their income, we classified as underreporters those taxpayers who (1) said they reported the income on other tax returns; (2) said the income reported by two or more payers was not theirs; and (3) did not respond to IRS' correspondence and IRS records showed they did not report the income on another type of return. We classified these three types of cases as underreporters because (1) reporting income on the wrong tax returns could change the tax liability of the return in question, (2) income was reported by two or more payers and IRS classifies individual taxpayers who claim no knowledge of such income as potential underreporters in its individual Information Return Program, and (3) IRS assesses individual taxpayers additional taxes when they do not respond to notices sent out under the individual Information Returns Program. The classification results for each sample are shown in table II.1.

Table II.1:
Classifications of Potential Underreporters

Taxpayer response	Number of cases		Percentage of total cases		Total	
Considered underreporters	Sample 1	Sample 2	Sample 1	Sample 2	Cases	Percentage
Admitted they underreported their income	13	9	7.2	1.6	22	3.0
Said income was reported on other tax returns	22	45	12.2	8.1	67	9.1
Said income reported by two or more payers was not theirs	0	8	0.0	1.4	8	1.1
Did not respond	13	33	7.2	5.9	46	6.2
Other[a]	6	15	3.3	2.7	21	2.8
Subtotal	54	110	29.8	19.7	164	22.2
Not considered underreporters						
Said income was reported on their pension plan returns	43	246	23.8	44.2	289	39.2
Said income was reported on their returns	50	71	27.6	12.7	121	16.4
Said their income as nominees for other taxpayers	3	52	1.7	9.3	55	7.4
Said income received from one payer was not theirs	19	17	10.5	3.1	36	4.9
Did not respond[b]	6	35	3.3	6.3	41	5.6
Other[c]	6	26	3.3	4.7	32	4.3
Subtotal	127	447	70.2	80.3	574	77.8
Total taxpayer responses	181	557	100.0	100.0	738	100.0

[a]The taxpayer's explanation of where the income was reported contradicted what the taxpayer actually reported on the tax return.

[b]Taxpayer had a pension plan and we made the assumption that the income was reported on the pension plan return.

[c]Taxpayer presented evidence that showed the income was not reportable or that the information return was in error.