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Report to the Chairman, Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, Committee on Finance, U.S. Senate

March 1991

TAX ADMINISTRATION

Expanded Reporting on Seller-financed Mortgages Can Spur Tax Compliance

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March 29, 1991

The Honorable David Pryor
Chairman, Subcommittee on Private
Retirement Plans and Oversight of
the Internal Revenue Service
Committee on Finance
United States Senate

Dear Mr. Chairman:

You requested that we study the use of certain third party information reports to assist in taxpayer compliance. This report responds to that part of your request regarding information reports for interest payments made under seller-financed mortgages (SFM).

Federal law requires banks and other financial institutions to provide the Internal Revenue Service (IRS) with the name and taxpayer identification numbers (TIN), generally the Social Security numbers (SSN), of persons who are paid interest income and the amount of the payment. The law also requires that at the end of the tax year a copy of the report be provided to the person who was paid the interest. Similarly, federal law requires taxpayers to report on their tax returns the names and SSNs of dependents being claimed as exemptions and of the person who received alimony or the person paid for providing child care services.[1]

IRS research has shown that this type of information is an important tool for increasing voluntary compliance with our nation's tax laws. When taxpayers know that IRS is aware of payments and has their names and SSNs, more will report the income on their tax returns. The purpose of this report is to examine whether the same taxpayer information should be provided to IRS for interest payments made under SFMs.

Background

Under an SFM, the individual seller finances all or part of the buyer's purchase of the property. The Internal Revenue Code requires that the seller pay tax on the interest income received from the buyer. IRS requires sellers to report on their tax return Schedule B (Interest and Dividend Income) of the Form 1040 the amount of interest income received from the buyer and the buyer's name.

[1] If a business provided the child care services, the taxpayer is required to report the business' employer identification number.

The Internal Revenue Code stipulates that buyers who itemize deductions can deduct their mortgage interest payments to sellers. IRS requires that buyers report sellers' names and addresses on their tax return Schedule A (Itemized Deductions) of the Form 1040. Federal law does not give IRS the authority to require buyers to provide sellers' SSNs, nor does IRS require buyers to send sellers a notice that IRS is aware of the interest payment made to them.

About 2.4 million buyers who itemized their deductions in 1989 reported that they paid sellers $6.4 billion in SFM interest. This is an increase from $3.6 billion in 1982.

Results

IRS has found that some taxpayers failed to correctly report SFM interest paid or received. In a 1985 study, IRS examined at 1 service center 1,495 1982 tax returns randomly selected from 21,100 in which buyers had deducted $5,000 or more in SFM interest. IRS was able to locate the corresponding seller's tax return for 517 of these buyers. The study found noncompliance and additional taxes owed in 11 percent of these 517 mortgage transactions—9 percent of sellers understated the interest income, and 2 percent of buyers overstated the interest deduction. IRS ultimately recommended 58 tax adjustments; the average tax adjustment for these productive cases was $1,335 for sellers and $459 for buyers.

The study also found, however, that IRS' enforcement efforts were severely hampered because IRS did not locate 978 of the 1,495 corresponding seller returns. In almost half of the 978 cases, the sellers' names and addresses on the buyers' tax returns were incomplete, missing, or illegible. Consequently, IRS could not manually identify sellers' SSNs and corresponding tax returns to compare the interest income reported with the amount of SFM interest deducted on the buyers' returns.[2]

The IRS study concluded that the number of SFMs would increase and, unless action was taken, noncompliance would continue. The study recommended that IRS obtain legislative authority to require buyers to report on their tax returns the sellers' SSNs. This study further recommended that, after legislation is enacted, IRS should study SFM reporting

[2]Other reasons cited for not locating sellers' tax returns were (1) the recipient was a financial institution rather than an individual, (2) IRS chose not to pursue sellers whose addresses were outside the Ogden Service Center area, and (3) the return was otherwise unavailable.

compliance and use the results to design an appropriate enforcement program. The American Bar Association made the same recommendation in a July 1987 report.

As of November 1990, IRS had not acted on the recommendation. IRS' Acting Director, Legislative Affairs Division, in response to our inquiry, said that IRS had not previously acted on the recommendation because of other legislative priorities. However, he also said that the recommendation appears to have a great deal of merit and that he had asked IRS staff to reconsider it as a potential legislative proposal to be forwarded to the Treasury for its consideration.[3]

Other SSN Reporting Appears to Have Improved Compliance

Congress has given IRS authority to require SSN reporting for claiming dependent exemptions, alimony payment deductions, and child care tax credits. When taxpayers do not comply with such reporting requirements, IRS has the authority to assess penalties or disallow claims. For example, IRS may impose a $50 fine and may disallow deductions for alimony payments when the payer fails to report the recipient's SSN. Also, a taxpayer who receives alimony income and refuses to provide his or her SSN to the alimony payer is subject to a $50 fine.

IRS data show that SSN reporting for other tax return items has appeared to improve compliance. For example, 20 percent fewer taxpayers claimed the alimony deduction and 15 percent more reported alimony income in the first year of SSN reporting (1985). Further, the number of child care providers filing Schedule C of Form 1040[4] increased by about 65 percent in the first year of the reporting requirement (1989). IRS officials said they believe that the reporting requirements accounted for a large portion of the improved compliance.

Total SFM Interest Payments Exceed Other Payments With SSN Reporting

Although SSN reporting is not required for SFM interest payments, the total amount of SFM interest payments exceeds payments for two other types of payments where federal law authorizes IRS to require SSN reporting. In 1989, SFM interest payments totaled an estimated $6.4 billion. However, taxpayers reported $4.0 billion in alimony payments and $2.5 billion in child care credits for 1989.

[3]Appendix I contains more information on IRS' 1985 study as well as other results discussed in this letter.

[4]Schedule C is filed by sole proprietors to report business profit or loss. Sole proprietors are individuals who do not organize their business operations as a partnership or corporation.

We believe that an SSN reporting requirement for SFMs might generate improved compliance and additional tax revenues. To illustrate, if we assume the noncompliance level in the 1985 study has not changed and apply it to all buyers and sellers in 1989, taxpayers in 264,000, or 11 percent of 2.4 million SFMs, either understated the interest income or overstated the deduction. On the basis of various assumptions about such noncompliance, we estimated that $129 million to $200 million in 1989 federal taxes may not have been paid. Our estimates and their assumptions and limitations are discussed in greater detail in appendix II.

Conclusions

As much as $200 million in 1989 federal taxes may not have been paid because of noncompliance in reporting SFM interest income and deductions. If legislation was enacted to require buyers to report sellers' SSNs, we believe, on the basis of IRS studies on the impact of information reporting, that most of this tax revenue would have been paid due to increased voluntary compliance. To pursue any remaining unpaid taxes, IRS could use the SSN as part of an enforcement program to identify sellers who fail to report SFM interest as well as buyers who overstate SFM deductions.

Recommendations to Congress

We recommend that Congress enact legislation to

- require buyers who deduct SFM interest to report on their tax returns the name and SSN of the seller and
- authorize IRS to penalize (1) buyers who fail to provide the sellers' SSNs and cannot show that they made reasonable efforts to obtain it and (2) sellers who refuse to provide their SSNs to buyers.

Recommendation to the Commissioner of Internal Revenue

If Congress enacts legislation to require buyers to report sellers' SSNs, we recommend that the Commissioner of Internal Revenue use the sellers' and buyers' SSNs to study the extent of taxpayer noncompliance and, on the basis of the study's results, implement an enforcement program, such as computer matching, to pursue cases of potential noncompliance.

Agency Comments and Our Evaluation

In a February 6, 1991, meeting, IRS officials provided comments on a draft of this report. They said that our recommendations to Congress have merit and should be given further consideration. In the draft, we recommended that if Congress enacted legislation, IRS should use SSNs in a computer matching enforcement program. However, IRS officials said computer matching may not be the most cost-effective enforcement program for pursuing noncompliant buyers and sellers. Another option could be some form of examination program. They believe that the type of enforcement employed should be dependent on and appropriate for the extent of subsequent noncompliance. To determine the extent of noncompliance, the officials said IRS would most likely have to study reporting noncompliance. We agreed with their reasoning and changed our recommendation to the Commissioner of Internal Revenue to include a study of noncompliance and to consider computer matching as one possible means of enforcement.

The Social Security Administration had no comments regarding the recommendations.

Objectives, Scope, and Methodology

Our objective was to determine what actions IRS could take to improve taxpayers' compliance in reporting SFM interest. To determine the amount of noncompliance, we analyzed IRS' 1985 study of SFM interest reporting in 1982. We then estimated the amount of noncompliance in 1989. In making our estimates, we used IRS Statistics of Income and Research Division data for 1982 to 1989 as well as various assumptions about the noncompliance rate for tax returns with SFM interest deductions of under $5,000 and $5,000 and over.

IRS' 1985 study of 1982 returns contains the only available data on taxpayers' compliance in reporting SFM interest income. The study, however, was limited because (1) its findings were based on a sample of returns drawn from only 1 of IRS' 10 service centers and (2) its results were statistically reliable only for returns with SFM interest payments of $5,000 or more. As a result, the findings could not be generalized to the entire universe of returns with SFM deductions.

To determine what actions IRS has taken and could take to improve compliance, we met with various IRS officials in the following divisions: Examination, Legislative Affairs, Research, Statistics of Income, and Tax Forms and Publications. We also spoke with an official at the Social Security Administration about reporting sellers' SSNs. In addition, we reviewed IRS' information returns forms and instructions as well as the American Bar Association's July 1987 report on taxpayer compliance.

Responsible officials at IRS and the Social Security Administration provided comments on a draft of this report. Their comments were incorporated where appropriate.

We did our work in Washington, D.C., from September to November 1990 in accordance with generally accepted government auditing standards.

As agreed with the Subcommittee, unless you publicly announce the contents of this report earlier, we plan no further distribution of the report until 30 days from the date of this letter. At that time, we will send copies to the Commissioner of Internal Revenue, the Commissioner of Social Security, and other interested parties. Copies will also be made available to others upon request.

Major contributors to this report are listed in appendix III. If you have any questions regarding this report, please call me on (202) 272-7904.

Sincerely yours,

Paul L. Posner

Paul L. Posner
Associate Director, Tax Policy
and Administration Issues

Contents

Abbreviations

IRS	Internal Revenue Service
SFM	seller-financed mortgage
SSN	Social Security number
TIN	taxpayer identification number

Improving Voluntary Reporting of Seller-financed Mortgage Interest

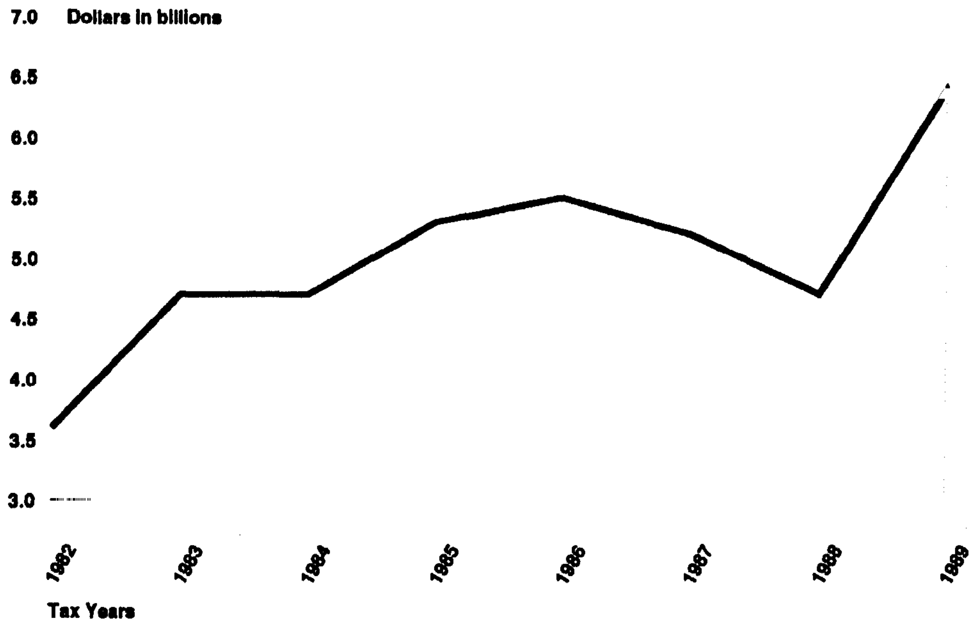
Background

Under seller-financed mortgages (SFM), property sellers finance the sale of all or part of their properties, and buyers make mortgage payments directly to the seller. Beginning with 1982 tax returns, the Internal Revenue Service (IRS) required (1) buyers to report on Schedule A (Itemized Deductions) of the Form 1040 sellers' names and addresses and the amount of SFM interest paid and (2) sellers to report on Schedule B (Interest and Dividend Income) the names of buyers who paid the SFM interest and the amount of SFM interest received.

Under section 6109(b)(1) of the Internal Revenue Code, IRS cannot require taxpayers to report another taxpayer's Social Security number (SSN) without specific legislative authority.

In 1982, buyers deducted $3.6 billion in SFM interest payments. This increased to $5.5 billion in 1986 and to $6.4 billion in 1989 (see fig. I.1).

Figure I.1: Amount of Seller-financed Mortgage Interest Deductions, 1982 to 1989



Source: IRS Statistics of Income Publications 1304 for 1982 to 1987; IRS Research Division for 1988 and 1989.

Information returns (i.e., documents filed with IRS by third parties to report certain payments and deductions) are IRS' primary source for detecting when taxpayers do not report all of their income. For example, IRS computer matches the income shown on information returns, such as savings account interest paid by banks, to the income shown on the recipients' tax returns. To do this match, IRS uses the recipient's SSN on the information return to identify the corresponding tax return. If the match indicates unreported income, IRS attempts to contact the taxpayer to resolve the discrepancy and assess any unpaid taxes, penalties, and interest. However, because buyers are not required to report the SSNs of sellers receiving SFM interest, IRS cannot identify and computer match corresponding buyer and seller tax returns.

IRS Found That Pursuing Noncompliant Sellers Was Difficult Without Their SSNs

In September 1985, IRS' Research Division issued a study of taxpayer compliance in reporting SFM interest income. IRS randomly selected a sample of 1,495 tax returns from the universe of 21,100 buyers who filed at the Ogden Service Center and deducted $5,000 or more of SFM interest in 1982.[1]

IRS attempted to use the information reported on the buyers' returns to find the corresponding sellers' returns. However, IRS could not locate 978 (65 percent) of the 1,495 sellers' returns. In almost half of the 978 cases, the sellers' names and addresses on Schedule A of the buyers' returns were illegible, incomplete, or missing. Other reasons cited for not locating the sellers' tax returns were (1) the recipient was a financial institution rather than an individual, (2) the address was not within the Ogden Service Center area and IRS decided not to pursue the return, or (3) the return was otherwise unavailable at the time of the study.

For the remaining 517 cases (35 percent), in which IRS could identify the sellers' SSNs and corresponding tax returns, IRS staff who process returns compared SFM interest income reported on sellers' tax returns to corresponding buyer deductions and tried to resolve discrepancies through correspondence with sellers. Unresolved cases were referred to the Examination Service Center Branch for audit.

Although the focus of the study was sellers, IRS also pursued leads that indicated the buyer may have overstated the deductions for SFM interest. This occurred when IRS determined that the seller had received less SFM interest than the buyer deducted.

[1]These 21,100 returns were about 9 percent of the 238,900 1982 tax returns filed at the Ogden Service Center with deductions for mortgage interest paid to individuals. IRS also selected a sample of tax returns on which buyers deducted less than $5,000 in SFM interest payments. However, IRS did not estimate noncompliance levels for those returns because too few were selected to make statistically reliable projections.

Of the 517 mortgages, IRS found that 9 percent of the sellers (46 cases) and 2 percent of the buyers (12 cases) did not correctly report at least $500 or more of SFM interest. The average adjustment for these productive cases was $1,335 for sellers and $459 for buyers.

The IRS study concluded that

> "In the absence of action by the Service to enhance compliance in this area, the frequency of occurrence and relative amount of lost revenue can be expected to continue and possibly increase; there is evidence that the number of individually financed mortgages and the amounts of these mortgages has been increasing. Since most mortgages are for multiple years it is reasonable to assume that noncompliant recipients (and payers) will continue to be noncompliant unless action is taken."

The study recommended that IRS (1) seek legislative authority to require buyers to report sellers' SSNs on Schedule A of Form 1040 and (2) when legislation is enacted, study the merits and nature of an enforcement program. As of November 1990, IRS had not implemented the recommendations. IRS' Acting Director, Legislative Affairs Division, in response to our inquiry, said that IRS had researched its files and found nothing to indicate what happened to the recommendation. He also said that IRS sought legislation in 1985 that would require taxpayers to furnish SSNs of dependents and day care providers. He speculated that the recommendation on SFMs was put on the "back burner" to avoid jeopardizing IRS' efforts to obtain legislation requiring these other SSNs. He concluded that the recommendation appears to have a great deal of merit and that he had asked IRS staff to reconsider it as a potential legislative proposal to be forwarded to Treasury for their consideration.

1989 SFM Tax Gap Estimates Range From $129 to $200 Million

To estimate the 1989 SFM tax gap—the difference between taxes voluntarily paid and taxes owed on SFM interest income—we applied the findings from IRS' study of 1982 returns to 1989 data on SFM interest deductions. We made several adjustments to IRS' 1985 study results to account for the growth in the average SFM interest deduction between 1982 and 1989 and to include returns with SFM interest payments less than $5,000. We estimated the SFM tax gap for 1989 ranged from $129 to $200 million. (See app. II for a more detailed description of our SFM tax gap calculations.)

SSN Reporting Has Helped Improve Voluntary Compliance in Other Areas

IRS research shows that when taxpayers know IRS is aware of a payment and their SSN, more will correctly report the payment on their tax return. IRS has legislative authority for SSN reporting related to dependent exemptions, alimony payments, and the child care tax credit. These three reporting requirements establish a precedent for using the SSN for reporting SFM interest payments. Following is a description of the requirements for SSN reporting related to dependent exemptions, alimony payments, and the child care tax credit:

Dependent Exemptions

Following provisions in the Tax Reform Act of 1986, taxpayers who claim a dependent exemption were required for 1987 to provide the SSN of any dependent age 5 or older.[2] Taxpayers who fail to report a dependent's SSN are subject to a $50 penalty. In 1986, taxpayers claimed about 77 million dependent exemptions. After the SSN requirement was implemented, taxpayers claimed about 70 million dependent exemptions. IRS officials estimate this difference resulted in the federal government collecting an additional $2.9 billion in revenue for tax year 1987.

Alimony

Federal law also requires taxpayers who pay alimony to report on their tax returns the SSN of the person receiving the payment. Individuals receiving alimony income are subject to $50 fines for refusing to provide their SSNs to payers. IRS may impose a $50 fine on and may disallow the alimony deduction for payers who fail to report recipients' SSNs. In 1985, when alimony SSN reporting was implemented, the number of returns reporting alimony payments dropped 20 percent from 1984 levels. In contrast, the number of returns showing alimony income increased by 15 percent from 1984 to 1985. The Tax Reform Act of 1984 altered the definition of alimony applicable to 1985 returns, which in our opinion may have accounted for some of this change.

Child Care Tax Credit

Taxpayers who apply for the child care credit must report the name, address, and taxpayer identification number (TIN) of the child care provider on Schedule 1 (Child and Dependent Care Expenses) for Form 1040A filers or on Form 2441 (Credit for Child and Dependent Care Expenses) for Form 1040 filers. The TIN for individuals providing child care is the individual's SSN. If a taxpayer fails to report the provider's TIN, the credit is not allowed unless the taxpayer can show due diligence in attempting to obtain the required information. Some child care providers report their income on Schedule C (Profit or Loss From Business

[2]The Family Support Act of 1988 changed the requirement to include dependents age 2 years or older. The Omnibus Budget Reconciliation Act of 1990 changed the requirement to include dependents age 1 year or older.

(Sole Proprietorship)).[3] IRS received about 244,000 Schedule Cs from child care providers in 1987 and about 261,000 in 1988. In 1989, the first year TIN reporting was required for the child care credit, preliminary IRS data show that about 430,000 child care providers filed Schedule Cs, a 65 percent increase over 1988. IRS officials believe a large portion of this increase was due to the new reporting requirement and not an increase in the number of child care providers.

IRS Has at Least Two Options for Increasing SFM Voluntary Compliance

If Congress provides the required legislative authority, IRS has at least two options for the buyer to report the seller's SSN. These options are to report the information on (1) an existing information return, such as Form 1098, which banks use to report mortgage interest payments to individuals or (2) their tax returns or an attached schedule, such as for alimony or child care reporting. Each method has advantages and disadvantages. We believe option 2 is better.

An advantage of option 1, using an existing information return, is that the buyer would send a copy of the information return to the seller during the tax return filing season. We believe this would provide a tangible reminder to the seller of his or her responsibility to report the interest income or risk an IRS action. Option 2, reporting the information directly on a tax return, probably provides a less tangible reminder because the seller may forget having provided his or her SSN to the buyer so it can be reported on the buyer's tax return.

A disadvantage to using an information return (option 1) is that it places an added burden on buyers to obtain and complete another form. Because individuals are normally not required to file information returns, they may not comply with the filing requirement. IRS would also incur costs to modify an existing information return and instructions to make SFM interest a reportable item.

Although IRS will incur costs to modify the tax return and instructions, an advantage of using the tax return (option 2) is that it should result in greater compliance in reporting the SSN than option 1. We believe taxpayers will find reporting the SSN on a tax return easier than completing a separate information return and mailing copies to the seller and to IRS. Option 2 is also the method now used by taxpayers to report SSNs of alimony and child care payment recipients.

[3] Sole proprietors are individuals who do not organize their business operations as partnerships or corporations.

As it has for dependent exemptions, alimony, and child care, Congress could establish penalties for (1) sellers who refuse to provide their SSNS to buyers and (2) buyers who fail to report sellers' SSNS.

Costs of an IRS Matching and Enforcement Program

We believe the major revenue gains from SSN reporting would result from improvements in voluntary compliance. Should IRS find that sufficient noncompliance remains to make an enforcement program cost effective, IRS could get additional revenue through an enforcement program such as computer matching. However, IRS enforcement efforts will carry certain costs.

If IRS instituted a computer matching program, it would first need to input data from either the information return or the buyer's tax return into an automated database. Then IRS would attempt to determine through a computer match whether the SFM interest reported by the buyer was reported on the seller's return. Where the match does not find an equivalent amount of income on the return, IRS tax examiners would pursue apparent seller underreporting or buyer overreporting through correspondence.

IRS estimated that the cost of entering 4.8 million buyer and seller SSNS into the computer would be about $92,000. IRS' study of 1982 returns found that in 21 percent of the cases, the amount of SFM interest the buyer deducted did not match the amount of SFM interest the seller reported.[4] If the same percentage applies for 1989, the total cost for service center actions on cases in which buyer and seller returns do not match would be about $6.7 million. This cost includes correcting errors made when entering SSNS, identifying buyer and seller returns that do not have identical SFM deduction and income amounts, pulling those returns, manually screening the returns to analyze the discrepancy, corresponding with taxpayers, issuing proposed adjustments and statutory notices of deficiency, and service center overhead. IRS would incur additional costs if cases unresolved through correspondence were referred to Examination for audit.

[4]Twenty-one percent of the 517 returns IRS initially obtained and screened showed a discrepancy of $500 or more between the SFM interest deducted by the buyer and the amount of SFM interest income reported by the seller. After IRS action (correspondence with the taxpayer or contact by an Examination official), IRS found additional taxes owed by 9 percent of sellers and 2 percent of buyers. The remaining cases were closed with no change in taxes owed.

American Bar Association Recommended That Buyers Be Required to Report Sellers' SSNs

In a July 1987 report,[5] the American Bar Association's Commission on Taxpayer Compliance noted that IRS should do more matching of deductions, adjustments, and credits on tax returns with corresponding income items on other returns. As an example, the report cited interest deductions for mortgages held by individuals (i.e., SFMS). The report also noted that although such cross-return matching would require some taxpayers to report other taxpayers' SSNs, "there does not appear to be much public resistance to doing so."

[5] American Bar Association Commission on Taxpayer Compliance Report and Recommendations, July 1987.

1989 Seller-financed Mortgage Tax Gap Calculations

Our estimates of the 1989 SFM tax gap were based primarily on the results of IRS' 1985 study of SFM interest reporting. However, the study was limited. Its sample included tax returns selected from only 1 of IRS' 10 service centers and was statistically reliable only for returns with SFM interest deductions of $5,000 or more filed at that service center. The study involved 1982 tax returns, and IRS has not updated its findings.

Given these limitations, we adjusted the study results to (1) account for the increase in the average size of SFM interest payments between 1982 and 1989 and (2) apply to returns with SFM interest payments less than $5,000. Accordingly, we calculated separate SFM tax gap estimates for buyer and seller returns with SFM interest payments less than $5,000 and $5,000 or more using various assumptions. We had to develop these assumptions because IRS did not have data available on the factors needed to calculate a tax gap estimate. As a result, we, in conjunction with IRS Examination staff, developed assumptions about these factors. IRS staff said these assumptions were reasonable since real data were not available. Following are the assumptions we made in calculating the tax gap estimate:

- The noncompliance levels found in the 1985 study apply to returns filed at all IRS service centers, not just those filed at the Ogden Service Center.
- Fourteen percent of 1989 returns with SFM interest deductions involved SFM interest payments of $5,000 or more. We based this assumption on an analysis of IRS' Statistics of Income database for 1987 individual income tax returns, the most recent complete data available at the time of our review. Our analysis showed that for 1987 returns, 14 percent of SFM deductions were for interest payments of $5,000 or more.
- The 1985 study finding that 9 percent of seller returns and 2 percent of buyer returns required adjustments applies to the entire SFM universe, not just to cases involving SFM interest of $5,000 or more.
- The amount of average tax adjustments increased by 32 percent between 1982 and 1989. We based this assumption on IRS data that show a 32-percent growth in the average SFM interest deduction from 1982 to 1989. For example, given average tax adjustments on 1982 returns of $1,335 on seller returns and $459 on buyer returns, we used our assumption of 32-percent growth to estimate 1989 averages of $1,762 for sellers and $606 for buyers.
- To establish a range of tax gap estimates, we assumed that average tax adjustments for returns with SFM deductions less than $5,000 were either 20 percent or 40 percent of average tax adjustments for returns with SFM deductions of $5,000 or more. We based the 20-percent

assumption on an IRS Examination official's estimate; although we could not verify the accuracy of this assumption, we have no basis to question it. The IRS official said that 20 percent was a conservative estimate; to establish the upper limits of our range, we assumed a less conservative 40-percent ratio.

Tables II.1 and II.2 show the tax gap calculations used to arrive at each total tax gap estimate.

Table II.1: 1989 Seller-financed Mortgage Tax Gap Estimate Using a Conservative Assumption

Type of return	Number of tax returns	Number of returns with tax adjustments[a]	Average tax adjustment per adjusted return	Tax gap estimate[b]
Seller returns				
With SFM interest income $5,000 or more	338,148[c]	30,433	$1,762[d]	$53,622,946
With SFM interest income less than $5,000	2,077,197	186,948	352[e]	65,805,696
Subtotal	**2,415,345**			**119,428,642**
Buyer returns				
With SFM interest deductions $5,000 or more	338,148[c]	6,763	606[d]	4,098,378
With SFM interest deductions less than $5,000	2,077,197	41,544	121[e]	5,026,824
Subtotal	**2,415,345**			**9,125,202**
Total tax gap				**$128,553,844**

[a]Assumes 9 percent of seller returns and 2 percent of buyer returns require tax adjustments.

[b]The tax gap estimate equals the number of returns requiring tax adjustments multiplied by the amount of the average tax adjustment per return.

[c]This represents 14 percent of the 2,415,345 tax returns with SFM interest deductions in 1989.

[d]This represents a 32-percent increase over the average tax adjustment for 1982 returns.

[e]This represents 20 percent of the average tax adjustment for returns with SFM deductions of $5,000 or more.

Table II.2: 1989 Seller-financed Mortgage Tax Gap Estimate Using a Less Conservative Assumption

Type of return	Number of tax returns	Number of returns with tax adjustments[a]	Average tax adjustment per adjusted return	Tax gap estimate[b]
Seller returns				
With SFM interest income $5,000 or more	338,148[c]	30,433	$1,762[d]	$53,622,946
With SFM interest income less than $5,000	2,077,197	186,948	705[e]	131,798,340
Subtotal	**2,415,345**			**185,421,286**
Buyer returns				
With SFM interest deductions $5,000 or more	338,148[c]	6,763	606[d]	4,098,378
With SFM interest deductions less than $5,000	2,077,197	41,544	242[e]	10,053,648
Subtotal	**2,415,345**			**14,152,026**
Total tax gap				**$199,573,312**

[a]Assumes 9 percent of seller returns and 2 percent of buyer returns require tax adjustments.

[b]The tax gap estimate equals the number of returns requiring tax adjustments multiplied by the amount of the average tax adjustment per return.

[c]This represents 14 percent of the 2,415,345 tax returns with SFM interest deductions in 1989.

[d]This represents a 32-percent increase over the average tax adjustment for 1982 returns.

[e]This represents 40 percent of the average tax adjustment for returns with SFM deductions of $5,000 or more.

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