

GAO

Testimony

Before the Subcommittee on Oversight,
Committee on Ways and Means
House of Representatives

For Release on Delivery
Expected at
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TAX ADMINISTRATION:

Money Laundering Forms
Could Be Used To Detect
Nonfilers

Statement of
Jennie S. Stathis, Director
Tax Policy and Administration Issues
General Government Division



054838/147039

MONEY LAUNDERING FORMS COULD BE USED TO DETECT NONFILERS

SUMMARY OF STATEMENT BY
JENNIE S. STATHIS
DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES
GENERAL GOVERNMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

Tax law (Sect. 6050I) requires any person engaged in a trade or business who receives more than \$10,000 in cash payments in a single transaction or series of related transactions to file a Form 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business). The business must file this form with IRS to report the name, address, and tax identification number of the purchaser as well as the amount of cash received, the purchase date and the product or service purchased. GAO used a sample of purchasers identified on 1,000 of these forms for payments made in November 1990 to test their usefulness in identifying potential nonfilers.

GAO found that over one-third of the forms either had no tax identification number or a number that may be incorrect. Without correct IDs, IRS cannot use the forms in computer matches to identify nonfilers and underreporters. IRS is developing an automated method that will allow businesses to validate an ID before a purchaser leaves the business. Applying this tool to Form 8300 transactions should increase the number of correct IDs reported on the forms.

GAO also found the forms can be useful in identifying potential nonfilers when correct IDs are provided. Of the 578 persons who provided correct IDs, GAO found that 123 (21 percent) did not file a 1990 tax return. Further investigation would be needed to determine whether their incomes were large enough to require a tax return. Through an inadvertent change, IRS did not use 8300 forms in its 1989 or 1990 computer matches to identify potential nonfilers. Recently, IRS corrected the mistake and will begin using the forms to identify nonfilers for tax year 1991.

Further, the forms can be useful in identifying taxpayers who file tax returns but underreport their income. IRS used a sample of the forms filed in 1985 and 1986 to select 855 tax returns for audit. IRS found unreported income in 50 percent of them. The unreported income totalled about \$15.3 million or about \$17,800 per return.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to assist the Subcommittee in its inquiry into the Internal Revenue Service's (IRS) efforts to use large cash payment reports (Form 8300) in its enforcement programs. These programs attempt to identify persons who have not filed required income tax returns (nonfilers) and those who have not reported all of their income (underreporters). You asked us to evaluate whether persons identified as having made large cash payments in November 1990 filed tax returns for 1990.

Tax law (Sect. 6050I) requires any person engaged in a trade or business who receives more than \$10,000 in cash payments in a single transaction or series of related transactions to file a Form 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business). The business must file this form with IRS to report the name, address, and tax identification number of the purchaser as well as the amount of cash received, the purchase date and the product or service purchased. We used a sample of these forms to test their usefulness in identifying potential nonfilers among the purchasers.

MANY FORMS 8300 HAD UNUSABLE
TAXPAYER IDENTIFICATION NUMBERS

We selected the first 1,000 Forms 8300 IRS received for November 1990. For various reasons, we were unable to obtain records on 18 of them. Of the 982 we reviewed, 374 (38 percent) were of little or no use for identifying nonfilers.

The first 228 (or 23 percent) had missing taxpayer identification numbers that prevented any match with IRS records of persons filing tax returns. Examples were

- a person in New York who paid \$60,000 cash for legal fees;
- a person in Florida who paid \$90,000 cash for a bronze sculpture; and
- a person in Florida who paid \$46,000 cash for a boat.

An additional 146 (15 percent) contained 9-digit taxpayer identification numbers for which IRS had no records of tax returns ever being filed. It is not clear whether these forms reflect potential nonfilers or invalid identification numbers. We believe it is reasonable to assume that money launderers who want to hide their identity or their nonfiling status from IRS would not want to provide their correct identification number.

Examples of these cases follow.

- A person in Connecticut paid \$34,000 in cash for blank

electronic tapes using a taxpayer number for which IRS has no record on the masterfile.

--A person in California purchased two recreational vehicles for more than \$65,000 in cash. A person with this taxpayer number has apparently never filed a tax return and has no record on the IRS masterfile.

--One person made four payments--3 in Missouri and 1 in Virginia--totaling \$51,000 in cash for armored car services. IRS has no record on the masterfile for this taxpayer number.

--A person paid \$17,000 cash for a timeshare condominium in Florida using a taxpayer number for which IRS has no record on the masterfile.

The Internal Revenue Code provides penalties for failing to provide complete and accurate Forms 8300. Given the large percent of incorrect tax identification numbers on the forms, we believe IRS may want to pursue other approaches, rather than relying solely on the deterrent effect of penalties, to achieve compliance with the filing requirement.

Another approach is under development at IRS for use with other types of information returns. This method would allow businesses to validate tax identification numbers before a transaction is completed. This could be done using any touch tone telephone or equipment similar to that used to approve credit card purchases. Those tax identification numbers found to be incorrect could then be corrected before the purchaser leaves the business. IRS is still considering questions such as who will bear the costs of the telephone call. We believe that IRS should also consider applying this approach to Form 8300 transactions.

Up-front validation may have the perverse effect of providing a disincentive for businesses to file the forms. Such an effect could occur if customers refuse to make purchases because their identification numbers are validated on the spot. This is a potential effect that IRS would have to be aware of as it continues its efforts to enforce the filing requirement.

IRS CAN USE FORMS 8300 TO IDENTIFY POTENTIAL NONFILERS

The remaining Forms 8300 were useful in identifying potential nonfilers whom IRS might not otherwise detect. These 608 forms identified 578 persons with valid tax identification numbers. Of this universe, 123 (or 21 percent) did not file 1990 tax returns although their cash payments on the forms in our sample averaged \$15,252. We would not know, of course, without further IRS investigation whether these 123 potential nonfilers had enough

income in 1990 to be required to file a tax return. We do know that only 6 of them had been identified as potential 1990 nonfilers through other IRS means.

Here are some examples of these cases.

- A. In two transactions in New York, potential nonfiler "A" paid over \$140,000 in cash for cigarettes. He last filed a tax return for 1985. IRS records had no information to explain why he has not filed since 1985 or why IRS has not pursued him as a nonfiler.
- B. In one transaction, potential nonfiler "B" purchased an automobile for \$14,000 cash. He last filed a tax return for 1987 and owes delinquent taxes totaling more than \$180,000.
- C. Potential nonfiler "C" apparently made a finance payment in Connecticut of over \$11,000 in cash. He has filed one tax return, for 1985, and has a delinquent tax debt of more than \$7,000. Since 1985, he has not filed a tax return or been identified as a nonfiler by IRS.
- D. Potential nonfiler "D" paid \$28,000 cash for cigarettes in New York. He filed tax returns annually through 1982, for the 6 years 1983 through 1988 in 1989, and no returns since then. His adjusted gross income ranged from \$400,000 in 1984 to almost \$2 million in 1988. IRS considers his outstanding tax debts--\$4.6 million--currently not collectible.
- E. Potential nonfiler "E" paid \$19,000 cash for beer from an imported beer distributor in Pennsylvania. While he filed no tax return for 1990, his 1991 tax return showed adjusted gross income of \$3,500.
- F. Potential nonfiler "F" paid \$60,000 cash for armored car services in Missouri. His last filed tax return, for 1987, showed adjusted gross income of about \$13,000.

FORMS 8300 INADVERTENTLY DROPPED
FROM IRS' COMPUTER MATCH

While IRS may have used Forms 8300 on a case-by-case basis to identify individual nonfilers, the forms have not been used systematically in IRS' computer matching program since tax year 1988. According to an IRS Collection official, the Examination division changed the computer program but did not notify Collection officials. The Examination change eliminated the Form 8300 from the nonfiler match for tax years 1989 and 1990. The

number of forms filed during these years grew from almost 20,000 in 1988 to more than 30,000 in 1990. The growth has continued; 71,000 were filed in 1991 and 35,000 in the first 3 months of 1992.

In previous years when IRS used the forms in a computer match, Collection officials said that the results were useful to identify nonfilers. In June 1992, Collection officials became aware of this Examination change and corrected the mistake. As a result, the nonfiler computer match for 1991, to be done later, this year is to include the Forms 8300.

Using all available tools to identify nonfilers makes sense, particularly when IRS officials believe that nonfilers threaten our voluntary tax system. IRS' strategic business plan for 1992 to 1997 identifies nonfilers as one of the 7 most serious types of noncompliance.

FORMS 8300 ARE USEFUL TO IDENTIFY UNDERREPORTERS

IRS has also found that Forms 8300 are useful to identify underreporters. In 1989, IRS completed a study to determine the usefulness of Forms 8300 to identify taxpayers underreporting their income. Using forms filed during 1985 and 1986, IRS selected a sample of about 1,200 individuals nationwide. Nine hundred were selected judgmentally among those who had the largest cash transactions and 300 were randomly selected.

After eliminating cases for various reasons, IRS audited 855 tax returns. IRS found unreported income in 50 percent of them. The unreported income totalled about \$15.3 million or about \$17,800 per return. Of the returns with unreported income,

--67 percent of the unreported income was only uncovered as a result of Form 8300 information.

--79 percent would not have been selected for an IRS audit without the Form 8300.

The study recommended that IRS begin an enforcement program using the Forms 8300 to identify underreporters. IRS officials told us they have begun testing ways to use the forms for this purpose.

Our sample of forms may have also provided some leads for identifying potential underreporters. These taxpayers made one cash payment in our sample that equaled or exceeded the adjusted gross income they reported for 1990. Some of these individuals also received the earned income tax credit, which is to go to taxpayers with children and less than \$20,264 in adjusted gross income.

Some examples of these cases follow.

- A person in Washington state reported less than \$6,000 in adjusted gross income but paid \$39,000 cash for life insurance.
- A Colorado resident paid taxes on less than \$16,000 in adjusted gross income but paid \$15,000 cash as a down payment on a Corvette.
- A person from California claimed about \$800 for the earned income tax credit, based on an adjusted gross income of less than \$12,000. He paid \$18,000 cash for a Toyota Celica.
- Another California taxpayer claimed about \$300 for the earned income tax credit, based on an adjusted gross income of about \$17,000. He paid \$17,000 cash for gold bullion.

While not conclusive alone, these leads could be used with other sources of information to help IRS identify underreporting.

SUMMARY

In summary, Mr. Chairman, our work suggests that Forms 8300 provide good leads to identify potential nonfilers and underreporters among those having enough cash to spend \$10,000 or more in one transaction. But the forms cannot be used for this purpose if they do not have a valid tax identification number. Ironically, the number of forms filed greatly increased during the same period that IRS inadvertently dropped the forms from its computer matching program.

Although IRS plans to begin using Forms 8300 again in its computer match, IRS needs to find a way to increase the portion with valid tax identification numbers. One way would be to require the businesses to validate the number before the customer leaves the business.

That concludes my statement Mr. Chairman. My colleagues and I would be pleased to answer any questions you or other members of the Subcommittee may have.

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