

September 1988

TAX
ADMINISTRATION

Accuracy of Taxpayer
Identification Numbers
on Information
Returns Can Be
Improved



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United States
General Accounting Office
Washington, D.C. 20548

General Government Division

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September 6, 1988

The Honorable Lloyd Bentsen
Chairman, Joint Committee on
Taxation

The Honorable Dan Rostenkowski
Vice Chairman, Joint Committee
on Taxation
Congress of the United States

In response to your request, this report discusses the need for more accurate taxpayer identification numbers on information returns. We are recommending steps that we think the Internal Revenue Service can take to achieve that end.

As arranged with the Committee, we are sending copies of this report to other congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties.

A handwritten signature in cursive script that reads "J. C. Finch" with "for" written below it.

Richard L. Fogel
Assistant Comptroller General

Executive Summary

Purpose

Each year, financial and other institutions (called “payors”) pay out hundreds of billions of dollars in interest and dividends and file information returns with the Internal Revenue Service (IRS) to report those payments. To ensure that recipients of the income (called payees) pay appropriate taxes, IRS matches data reported by payors on their information returns with income reported by payees on their tax returns.

The success of IRS’ matching depends, in part, on payors accurately reporting payees’ identification numbers, which are generally Social Security numbers. If the identification number on an information return is missing or incorrect, IRS may not be able to include that return in its matching program, thus compromising IRS’ ability to detect underreported income and collect any resulting tax. Accordingly, Congress established requirements and penalties to encourage accurate reporting of identification numbers.

In response to a request from the Joint Committee on Taxation, GAO assessed the procedures IRS established to implement those requirements and enforce those penalties. In assessing those procedures, GAO focused on steps IRS can take to improve the accuracy of payee identification numbers and thus improve the usefulness of interest and dividend information returns in IRS’ matching program.

Background

The Interest and Dividend Tax Compliance Act of 1983 sets specific requirements for payors to follow in submitting interest and dividend information returns to IRS. When IRS receives those returns from payors, it matches the payees’ identification numbers on the returns with the numbers assigned to those payees in IRS and Social Security files. IRS sends back to the payors numbers that do not match and asks them to certify, under penalty of perjury, that they exercised “due diligence” in trying to obtain correct identification numbers.

To exercise due diligence, payors must comply with Department of the Treasury guidelines that specify steps payors must follow to obtain correct identification numbers. One step a payor must take to exercise due diligence is withhold and remit to the Treasury 20 percent of all interest and dividend payments made to a payee who failed to provide a correct identification number. Payors who fail to withhold are liable for the amount not withheld. Payors who fail to exercise due diligence are also subject to a \$50 penalty for each account affected. (See pp. 13 and 14.)

Of the 405.6 million interest and dividend returns IRS received for tax year 1985 (the most recent year for which complete data was available), the identification numbers on 28.4 million could not be matched to IRS or Social Security files. Of those nonmatches, 5.5 million involved returns with missing identification numbers; the rest involved returns with incorrect numbers. IRS was able to correct 11.6 million of those numbers through computerized techniques. The numbers on the other 16.8 million returns could not be corrected, and thus those interest and dividend returns could not be used in IRS' matching effort. (See pp. 10 and 11 and 17 to 20.)

Results in Brief

GAO identified several steps IRS could take to improve the accuracy of payor identification numbers and thus the usefulness of interest and dividend returns in IRS' matching program. Those steps involve (1) enforcing the 20 percent withholding requirement, (2) reducing the volume of incorrect identification numbers for which payors are asked to certify due diligence, (3) providing payors with more timely information on missing or incorrect identification numbers, and (4) doing additional research to resolve more incorrect numbers.

Principal Findings

Enforce Withholding Requirement

Although Treasury issued regulations in September 1983 to implement the withholding requirement as it applies to missing identification numbers, IRS has not been enforcing that requirement. It is not monitoring the extent to which payors are withholding nor determining the reasons for nonwithholding. Because some payors are exempt from withholding, neither GAO nor IRS knows how much is not being withheld that should be. If none of the nonwithholding were exempted, the figure could be as much as \$2.4 billion. (See pp. 17 to 19.)

Because withholding limits the amount of interest or dividends a payee actually receives, it can serve as an incentive for payees to provide correct identification numbers. The benefit might be more fully achieved if IRS were to enforce the withholding requirement. IRS officials said most of their time had been devoted to developing other procedures relating to the provision of correct identification numbers on interest and dividend returns, and thus they had made little progress in developing a system to monitor withholding.

**Reduce Volume of
Incorrect Numbers
Referred to Payees**

Payors are required to exercise due diligence in obtaining payees' identification numbers, not payees' names. However, many of the "incorrect" identification numbers included on the lists IRS sends payors for due diligence certification are only considered incorrect because the names associated with those numbers on the information returns are not the same as the names on IRS or Social Security files. IRS could resolve many of the name mismatches on information returns by using two data files it now uses to correct identification numbers on other returns. Use of those files could reduce the volume of incorrect numbers referred to payors for resolution. After GAO discussed that possibility with program officials, IRS used the two files in an attempt to resolve missing identification numbers on about 19 million tax year 1986 information returns. About 10 percent of the numbers were resolved. (See pp. 23 to 25.)

**Provide More Timely
Information to Payors**

IRS' current schedule for sending lists of missing and incorrect identification numbers to payors does not allow payors sufficient time to correct their files before submitting the following year's information returns. For tax year 1984, for instance, IRS did not begin sending out numbers until May 1986. Payors told GAO they needed the numbers by October 1985 to allow them time to correct their data before the February 1986 deadline for submitting tax year 1985 information returns. IRS officials said that, starting with the list for tax year 1987, they intend to start sending numbers to payors in November, after first matching those numbers against the two files discussed earlier. The officials believe that a November mailing will give payors sufficient time to correct their data before the following year's information returns are due. GAO agrees, assuming IRS' match significantly reduces the volume of numbers on the list. (See pp. 25 to 27.)

**Do Research to Resolve
More Incorrect Numbers**

IRS could increase the number of interest and dividend returns in its matching effort by using available manual research procedures to resolve erroneous identification numbers. In December 1987, IRS completed a test of those procedures, on interest and dividend returns with missing identification numbers. If after assessing the test results, IRS decides to start using those procedures, it should consider including returns with incorrect numbers as well as missing numbers. The impact of that expansion on IRS resources could be minimized if IRS focused on returns with the greatest yield potential. (See pp. 28 to 30.)

Recommendations

GAO recommends that IRS establish and implement procedures to (1) determine whether payors are complying with withholding requirements on interest and dividend returns and (2) enforce that requirement.

Also, if IRS, after assessing its test results, decides to use manual research procedures on interest and dividend returns with missing identification numbers, GAO recommends that it consider expanding that use to returns with incorrect numbers and focus on returns with the highest potential to yield additional taxes.

Agency Comments

IRS agreed with GAO's recommendations and general conclusions but took exception to GAO's estimate as to the amount of money that should have been withheld but was not. This report has been revised to make it clear that the \$2.4 billion represents potential nonwithholding and that an unknown portion may be covered by withholding exemptions. (See pp. 18 to 22 and 30.).

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Abbreviations

GAO	General Accounting Office
IDTCA	Interest and Dividend Tax Compliance Act
IRP	Information Returns Program
IRS	Internal Revenue Service
TIN	Taxpayer Identification Number

Introduction

Each year, financial and other institutions (called “payors”) pay out billions of dollars in interest and dividends and file information returns with the Internal Revenue Service (IRS) to report those payments. To ensure that the recipients of interest and dividends (called “payees”) pay appropriate taxes on that income, IRS, through its Information Returns Program (IRP), matches income payments reported by payors on their information returns with income receipts reported by payees on their tax returns.

The success of IRP depends, in part, on payors reporting accurate information to IRS. One such piece of information is the payee’s taxpayer identification number (TIN).¹ If the TIN on an information return is missing or incorrect, IRS may not be able to include that return in IRP, thus compromising IRS’ ability to detect underreported income and any resulting tax consequences. To better insure correct TINs, payors are required by law to exercise due diligence in obtaining those numbers from payees. Exercising due diligence generally means payors must certify that they requested valid TINs from payees. If payors cannot certify that they exercised due diligence, they must assess themselves a penalty—referred to by IRS as the TIN penalty.²

In October 1986, the Joint Committee on Taxation asked us to study IRS’ administration of civil penalties associated with IRP. After making preliminary inquiries into several penalties, we agreed with the Committee to limit our review to IRS’ procedures for administering the TIN penalty. Collectively, those procedures are referred to as the TIN Penalty Program.

Information Returns Program

The Revenue Act of 1962 required a payor of wages, interest, dividends, or other forms of income to file information returns with IRS and, in most cases, provide copies of the returns to the payees. Those returns include, among other things, the payee’s name and TIN, and the amount and type of income paid. Under IRP, IRS matches the income reflected on the information returns with the income reported on the payees’ tax returns to identify unreported income.

¹A TIN is either an individual’s Social Security number or a 9-digit employer identification number which is assigned to businesses by IRS.

²According to section 6676(d) of the Internal Revenue Code, the penalty for failure to provide correct TINs with respect to interest or dividends is to be treated as an excise tax for tax administration purposes. Thus the self-assessment feature.

Although the act requires the filing of information returns to report income payments to all payees, IRS' matching process only applies to nonbusiness payees. As a result of hearings before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Committee on Government Operations, at which we testified,³ IRS has developed a plan to study the feasibility of developing an IRP for business taxpayers.

How IRP Works

IRP begins when IRS receives information returns from payors. Interest and dividend returns are due to IRS, either on paper or on magnetic media,⁴ by February 28th of the year following the payment. IRS processes paper information returns at its 10 service centers. The centers use optical character recognition equipment to scan the information returns and transcribe them to magnetic tape, which is then shipped to IRS' National Computer Center in Martinsburg, West Virginia. Information returns filed on magnetic media go directly to the National Computer Center.

The National Computer Center first processes the information returns through various validity checks. One of those checks involves matching the returns against Social Security Administration and IRS files of valid TIN/payee name combinations to determine whether the TINs on the information returns are correct. The Social Security file shows the name and any name changes associated with each assigned Social Security number while the IRS file contains information on names associated with employer identification numbers. On the basis of this match, the National Computer Center identifies those returns with missing or incorrect TINs. IRS considers a TIN to be missing if no number is provided or if the number provided has less than 9 digits. IRS considers a TIN to be incorrect if either the name or number provided on the information return does not match the name and associated number on the records of the Social Security Administration or IRS.

The National Computer Center places those information returns with correct TINs (those that match Social Security or IRS files) in the Information Returns Master File. Returns with missing or incorrect TINs move to

³The Merits of Establishing a Business Information Returns Program (GAO/T-GGD-87-4, Mar. 17, 1987).

⁴Payors that file 50 or more information returns are required to file on magnetic media, such as computer tapes and disks, unless they request and are granted a waiver.

what IRS calls the TIN perfection process. That process involves a computerized search of IRS' Individual and Business Master Files⁵ for an address similar to the address shown on the information return. If the process locates an address similar to the one on the information return and the TIN or name on the information return is similar to the TIN or name on the master files, IRS considers the TIN "perfected" (corrected). IRS then adds information returns with corrected TINs to the Information Returns Master File. Those returns that still have missing or incorrect TINs after TIN perfection cannot be used in the current year's IRP matching process and are placed on IRS' Unperfected Information Returns File.

The National Computer Center computer matches data in the Information Returns Master File with information reported on the payees' income tax returns. If the income recorded in the Master File does not match the income reported on a tax return and the discrepancy has the potential for a tax adjustment in excess of a predetermined amount, the payee is identified as a potential underreporter. The National Computer Center sends tapes containing information on potential underreporters to the 10 service centers. From the tapes, the service centers generate transcripts that they use to manually compare data in the Information Returns Master File with data on the tax return. This manual comparison might find, for example, that the taxpayer reported the income in question but listed it in the wrong place on the tax return, thus causing the computer to overlook it. If the income cannot be identified on the return, the service center sends the taxpayer a notice identifying the discrepancy and proposing an adjustment to the taxpayer's tax liability. Upon receipt of IRS' notice, taxpayers have several options. Among other things, they can pay the additional tax proposed by IRS or they can provide additional information in an attempt to explain the discrepancy.

As depicted in figure 1.1, the above IRP process takes over a year.

As shown in table 1.1, of the 405.6 million interest and dividend returns submitted in tax year 1985, the TINs on about 4 percent, or 16.8 million, could not be validated and could not be corrected through the TIN perfection process. This represents \$106.9 billion or 16 percent of total interest and dividend payments.

⁵IRS' Individual and Business Master Files contain entity and account information for each individual and business taxpayer. Entity information is information such as the taxpayer's name, address, and TIN.

Chapter 1
Introduction

Figure 1.1: Tax Year 1985 Information Returns Processing Time Frames

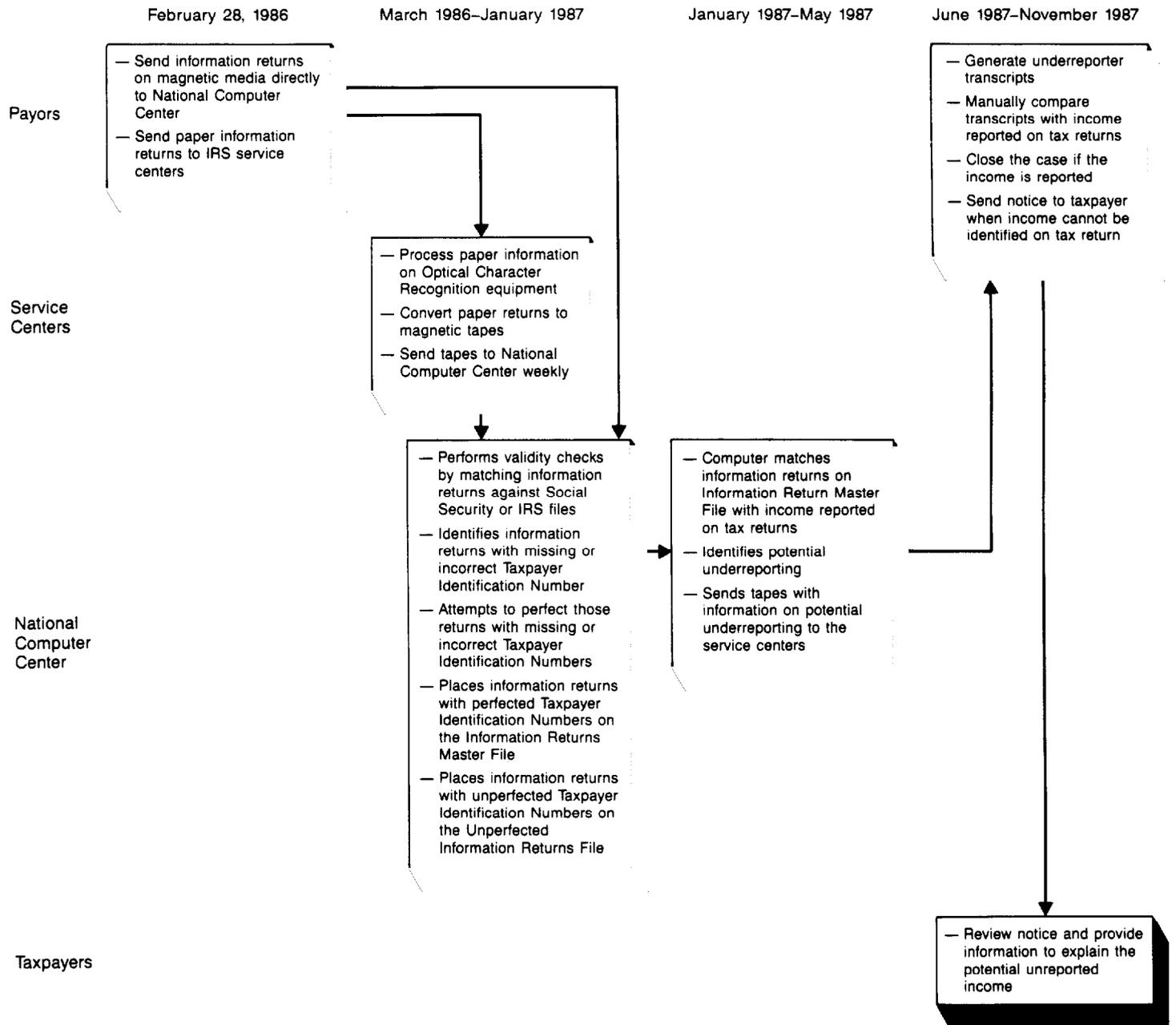


Table 1.1: Tax Year 1985 IRP Statistics - Interest and Dividend Returns^a

Dollars in billions

	Number of returns	Percent of total	Interest and dividend payments	Percent of total
Total returns received by IRS	405,615,827	100.0	\$658.6	100.0
Validated returns ^b	377,177,555	93.0	\$489.1	74.3
Unvalidated returns sent to TIN perfection	28,438,272	7.0	\$169.5 ^c	25.7
Corrected returns	11,614,923	2.9	\$62.6	9.5
Uncorrected returns	16,823,349	4.1	\$107.0	16.2

^aWe developed this information from an analysis of data maintained on IRS' tax year 1985 Information Returns Master File and Unperfected Information Returns File.

^bReturns that matched against Social Security or IRS files.

^cTotal does not add due to rounding

Major Legislation Affecting IRP

To ensure that payors submit sufficient, accurate, and timely data about payees to IRS, Congress in recent years has expanded and modified information returns reporting requirements and has increased the penalties that IRS may assess in response to specific violations of those requirements.

The Tax Equity and Fiscal Responsibility Act of 1982 increased the payor penalty for failure to provide a correct TIN on an information return from \$5 to \$50 per failure, with a cap of \$50,000 per payor per year. The Interest and Dividend Tax Compliance Act of 1983 (IDTCA) targeted payors of interest and dividends for more stringent requirements and penalties than those imposed by the 1982 act. IDTCA imposed

- a \$50 penalty per failure with no cap and
- a requirement that interest and dividend payors exercise “due diligence” rather than “reasonable cause” in obtaining and providing TINs that the payees certify as being correct (referred to herein as “certified TINs”).

Before IDTCA, a payor could be excused from paying a penalty for not providing a correct TIN if the payor had reasonable cause for the failure, such as the loss of business records, a mail delay, or staff illness. IDTCA imposed the more stringent due diligence requirement. To exercise due diligence, payors must comply with specific Department of the Treasury guidelines for obtaining certified TINs. For accounts in existence before January 1, 1984, payors were required to make a separate first-class

mailing on or before December 31, 1983, to any payee who had not provided a TIN or who had provided a TIN but had not certified under penalty of perjury that the TIN provided was correct. Payors were also directed to make annual mailings to those payees who did not respond to the initial letter. The purpose of the mailings was to obtain certified TINs. For accounts opened after December 31, 1983, payors are required to obtain a certified TIN on all accounts when the accounts are opened or soon thereafter.

In addition to the mailings, the Internal Revenue Code requires payors to withhold and remit to the Treasury 20 percent of all interest and dividend payments made to a payee's account if the payee has not provided a certified TIN. Payors who fail to withhold under these circumstances are liable for the amount not withheld. These payors are also subject to a \$50 penalty per account for failure to exercise due diligence.

Passage of IDTCA led to IRS' establishment of the TIN Penalty Program effective January 1, 1984. That Program is administered by IRS' Tax Accounts and Underreporters Branch in the Office of the Assistant Commissioner for Returns and Information Processing.

TIN Penalty Program

The Internal Revenue Code requires all payors who file information returns showing interest and dividend payments to exercise due diligence in obtaining certified TINs. To conserve its resources, however, IRS has limited its TIN Penalty Program to payors who file 50 or more returns on magnetic media. This accounted for 361.3 million of the 405.6 million interest and dividend information returns filed for tax year 1985.

IRS began enforcing the TIN Penalty Program for tax year 1984 information returns. For that year, IRS concentrated on payors submitting more than 1,000 interest and dividend information returns with missing or incorrect TINs. According to IRS officials, this allowed them to concentrate on a relatively small group of payors who had submitted a large number of information returns that could not be used in IRP.

In May and June 1986, IRS sent those payors lists identifying all accounts with missing or incorrect TINs. The lists contained payee account information (account number, name, TIN, and address), and the payors were asked to certify, under penalty of perjury, whether they had exercised due diligence in obtaining the TINs. Payors were required to self-assess a \$50 penalty for each account on which they determined

they had not exercised due diligence. Of the 4,135 payors who were contacted, 1,189 (or 29 percent) said they had not exercised due diligence on some or all of their accounts. These payors self-assessed \$56 million in penalties. TIN Penalty Program officials told us that some payors have asked IRS to abate their penalties because they believe, after further study, that they met due diligence requirements. As of February 1, 1988, IRS was still reviewing those requests.

In an attempt to cover payors who might have been missed because of the more-than-1,000 criterion in the 1984 program, IRS focused its tax year 1985 TIN Penalty Program on payors who submitted from 50 to 1000 information returns with missing or incorrect TINs. In November 1986, IRS sent those payors lists of accounts with missing or incorrect TINs and asked them to certify whether they had exercised due diligence. As of February 1, 1988, 5,724 (or 27 percent) of the 20,835 payors contacted had self-assessed \$110,558,462 in penalties for not exercising due diligence.

IRS has no program specifically directed at verifying whether payors are exercising due diligence. Whatever verification exists is being done as part of the package audits done by IRS' Examination Division.⁶ In June 1987, as a step toward identifying payors who improperly certified they had exercised due diligence, TIN Penalty Program officials provided the Examination Division with a list of payors contacted in the tax year 1984 TIN Penalty Program. They asked Examination to determine whether any payors on this list were undergoing a package audit. If so, auditors were asked to examine payor compliance with due diligence and to assess penalties where applicable. No information was available at the time of our review on the extent to which due diligence was being verified during package audits or on the results of any such verification.

IRS is also reviewing the civil penalty structure in the Internal Revenue Code, of which information return penalties are a part. IRS expects to be releasing recommendations later this year that will be directed at more effectively administering penalties and encouraging compliance.

⁶Package audits are audits during which taxpayers, whose returns are being examined by IRS for any reason, are also checked for compliance with other filing requirements.

Objective, Scope, and Methodology

As agreed with the Joint Committee, our objective was to assess IRS' administration of the TIN Penalty Program and the processes established to implement and monitor the program. These processes include the procedures IRS follows to (1) enforce withholding requirements when payors submit returns with missing or incorrect TINs, (2) provide accurate and timely information to payors, and (3) reduce missing and incorrect TINs on information returns.

To accomplish our objective, we interviewed officials involved with the administration of the TIN Penalty Program at the Department of the Treasury, and at IRS' National Office, Cincinnati Service Center, Fresno Service Center, and National Computer Center. We selected Cincinnati because all of IRS' mailings to payors associated with the tax year 1984 TIN Penalty Program were made out of that service center. Since then, each service center has handled its own mailings. We selected Fresno because of the availability of GAO staff and because IRS officials told us all service centers should follow the same procedures in administering the program. We reviewed legislation pertaining to the requirements for filing information returns and reviewed Treasury regulations and IRS procedures pertaining to the TIN Penalty Program.

IRS provided statistical information on tax year 1985 interest and dividend returns that it extracted from the Information Returns Master File and Unperfected Information Returns File. Tax year 1985 information was the latest available when we did our audit work. By reviewing the computer programs IRS used to extract information from the files, we satisfied ourselves that the programs should produce the information we were seeking. We did not verify the data obtained from the files against that in source documents. Because the statistical information was not segregated between individual and business payees, we were unable to present data showing the effect on the present IRP, which relates only to individual taxpayers. The aggregate information is significant, however, because it shows the extent to which the requirements of IDTCA and the TIN Penalty Program, which apply to all interest and dividend returns, are being met. The aggregate information also shows what the effect might be on the overall IRP effort if IRS were to eventually implement a business IRP.

We obtained a private-sector perspective on the TIN Penalty Program through interviews with 34 payors from California, Connecticut, Maine, Michigan, New Jersey, New York, North Carolina, Ohio, and Washington, D.C. We selected some of those payors judgmentally and selected others on the basis of referrals from trade associations representing the

banking and securities industries, saving and loans institutions, credit unions, and insurance companies—the kinds of businesses that pay interest and dividend income. The payors interviewed had been contacted by IRS as part of the tax year 1984 or 1985 TIN Penalty Program, and ranged from small credit unions with \$7.7 million in assets to major banks with assets of \$20 billion. We also interviewed representatives from the trade associations to obtain their views on the program. Appendix I lists the institutions included in our review.

We made our review in accordance with generally accepted government auditing standards. We did our work from November 1986 to March 1988.

IRS Should Enforce Payor Withholding

Among other things, the Tax Equity and Fiscal Responsibility Act of 1982 imposed a mandatory 10-percent withholding on interest and dividend payments. IDTCA repealed mandatory withholding and, in its place, established a requirement that payors withhold taxes at a rate of 20 percent from interest and dividend payments made to payees who failed to provide a TIN or who provided an incorrect TIN. Payors who fail to withhold are liable for the amount not withheld. They are also liable for a penalty of \$50 per account for failing to exercise due diligence.

Although Treasury issued regulations in September 1983 to implement the withholding requirement as it applies to missing TINs, IRS has not been monitoring or enforcing that requirement. For tax year 1985—the latest full year for which statistics were available for our review—IRS records showed that payors did not withhold on 64 percent of the approximately 5.5 million returns submitted with missing TINs, withholding that could have amounted to as much as \$2.4 billion. IRS did not assess any of those payors for the taxes not withheld.

For the same period, payors of interest and dividends submitted about 23 million information returns with incorrect TINs. Because regulations to implement the withholding provision as it applies to incorrect TINs were not issued until November 1987, payors were not required to withhold on any interest and dividends paid to payees in this group.

Because withholding limits the amount of interest and dividends actually remitted to payees, it can serve as an incentive for payees to provide payors with correct TINs. Until IRS enforces the withholding requirement, however, that incentive will be less than fully effective.

Payors Do Not Withhold Taxes on Most Accounts With Missing TINs

IRS considers a TIN to be missing if no number is provided on the information return or if the number provided contains less than nine digits. In cases involving a missing TIN, according to IDTCA and Treasury regulations issued in September 1983, payors must withhold at a rate of 20 percent on any interest and dividend payments made to the payee's account after December 31, 1983. Once withholding begins, it must remain in effect until a TIN is provided.

As shown in table 2.1, about 5.5 million tax year 1985 interest and dividend information returns were filed with missing TINs, but in most of those cases the payors did not withhold taxes.

Table 2.1: Interest and Dividend Returns Filed With Missing TINs - Tax Year 1985^a

Dollars in billions

	Number of returns	Interest and Dividend Payments
Total interest and dividend information returns	405,615,827	\$658.6
Returns subject to withholding because of missing TINs	5,471,926	\$12.1
with withholding	1,974,651	\$.3
without withholding	3,497,275	11.8

^aIRS extracted these figures from IRS' Information Returns Master File and Unperfected Information Returns File for tax year 1985.

We considered several reasons for the large occurrence of nonwithholding. We considered the possibility that payors were not aware of their withholding responsibilities. IRS sent every payor a copy of the pertinent regulations, however, and the payors we talked to indicated that they were aware of the withholding requirement. Another possibility raised by some payors was that the amounts of interest and dividend payments involved were too small to warrant withholding. IDTCA exempts payors from withholding on any interest or dividend payment of less than \$10. According to IRS' statistics, however, of the 3.5 million information returns for which there was no withholding, only about 700,000, totaling less than \$2 million, involved amounts of less than \$10.

We believe that a major contributor to the significant incidence of nonwithholding could be the fact that IRS does not monitor or enforce the withholding provisions. IRS Form 941 (Employer's Quarterly Federal Tax Return) is used by payors to report withholding. Also, the information returns used to report interest and dividend payments contain a space where payors are supposed to record amounts withheld. Although IRS could use these forms to determine whether payors are withholding as required, it does not.

IRS officials responsible for administering the TIN Penalty Program told us they recognize that some payors are not withholding as required. They added, however, that most of their time has been devoted to developing and refining procedures for service centers to use in implementing other aspects of the TIN Penalty Program, such as those relating to the penalties payors are to assess themselves for not exercising due diligence. As a result, they have made little progress in developing a system to monitor payor withholding. According to one official, IRS hopes to have such a system in place in 1989.

Because IRS does not monitor withholding, it does not know how much is not being withheld that should be and has no basis on which to assess payors who fail to withhold. Considering that (1) 2.8 million tax year 1985 interest and dividend returns involving payments of \$10 or more and totaling about \$11.8 billion were submitted with missing TINs and without withholding and (2) payors are supposed to withhold at the rate of 20 percent, we estimate that the potential amount of tax not withheld for tax year 1985 could be as much as \$2.4 billion.

IRS commented on a draft of this report by letter dated June 15, 1988 (see app. II). In its comments, IRS voiced disagreement with our estimate of potential nonwithholding. It noted, for example, that many of the TINs might be missing for legitimate reasons, such as the fact that certain individuals and organizations are not required to obtain TINs. We do not disagree. Because it does not monitor withholding, however, IRS has no specific information on the extent to which the existence of missing TINs is legitimate. Absent that information, we have no way of determining how much of the potential \$2.4 billion in nonwithheld taxes is associated with legitimately missing TINs.

IRS pointed out also that its research data suggests that taxpayers voluntarily report a high percentage of their interest and dividend income and thus the absence of withholding does not necessarily equate to a "dollar-for-dollar noncompliance and revenue loss." We agree that the absence of withholding does not equate to a dollar-for-dollar loss in revenue. We would point out, however, that the high percentage of voluntary compliance suggested by IRS' research is abetted by the fact that taxpayers know IRS has information returns in hand that it can match against tax returns. That incentive is absent in cases involving information returns with missing TINs because without a TIN IRS cannot match.

Payors Are Not Withholding Taxes on Accounts With Incorrect TINs

IRS considers a TIN incorrect if either the name or number on an information return does not match the name and associated number in Social Security or IRS files. As shown in table 2.2, payors submitted about 23 million information returns with incorrect TINs for tax year 1985.

Table 2.2: Interest and Dividend Returns Filed With Incorrect TINs - Tax Year 1985^a

Dollars in billions		
	Number of returns	Interest and dividend payments
Total interest and dividends information returns	405,615,827	\$658.6
Returns submitted with incorrect TINs	22,966,346	\$157.5

^aIRS extracted this information from its Information Returns Master File and Unperfected Information Returns File for tax year 1985.

Although IDTCA requires withholding in cases involving incorrect TINs, payee compliance with that provision had been deferred until Treasury issued guidance to assist payors in understanding their responsibilities with respect to incorrect TINs. In November 1987, Treasury issued that guidance in the form of temporary regulations. Treasury and IRS officials told us that issuance of the regulations had been delayed because of several issues that had to be resolved including the need to decide on an appropriate definition of an incorrect TIN. The definition they finally settled on is the one in the previous paragraph.

The temporary regulations provide instructions to payors on what they must do when IRS notifies them that a payee has provided an incorrect TIN. If so notified, a payor must advise the payee that 20-percent withholding will apply unless the payee provides the payor with a certified TIN within 30 business days. Once withholding starts, it is to continue until the payor receives the certified TIN. Also, if IRS notifies the payor twice within a 3-year period that the payee has provided an incorrect TIN, and if the second incorrect TIN is still being used, the payor must advise the payee that withholding will be imposed and that the payor will ignore any future TINs received from the payee until IRS notifies the payor that the payee has provided a correct TIN.

In commenting on a draft of this report, IRS noted that it would be unreasonable to assume that withholding would have been required in each of the 23 million cases involving incorrect TINs. IRS pointed out that in many cases the payor, upon being notified of an incorrect TIN, would obtain a certified TIN, thus obviating the need to withhold. We agree.

Conclusions

Correct TINs on interest and dividend information returns are vital if IRS is to use those returns in determining, through IRP, whether payees are appropriately reporting such income on their tax returns. IDTCA and the TIN Penalty Program are directed at either (1) getting an information

return with a correct TIN so it can be matched as part of IRP or (2) absent such a return, protecting government revenues by having the payor withhold 20 percent from each interest and dividend payment made on an account that does not have a correct TIN.

Because withholding limits the amount of interest or dividends actually remitted to payees, it can serve as an incentive for payees to provide correct TINs. The benefits from that incentive are not being fully realized, however, because IRS has not been enforcing the withholding requirement. It is not monitoring the extent to which payors are withholding nor determining the reasons for nonwithholding. As such, it has no basis for determining whether the payee was exempt from withholding or whether the payor should have withheld but did not, thus making the payor liable for the amount not withheld plus a \$50 penalty for failing to exercise due diligence.

Recommendation to the Commissioner of Internal Revenue

To ensure better compliance with information return reporting requirements and a more effective and accurate TIN Penalty Program, we recommend that IRS establish and implement procedures to determine whether payors are complying with withholding requirements on interest and dividend information returns and to enforce that requirement, including the assessment of any penalty where appropriate.

Agency Comments and Our Evaluation

In commenting on a draft of this report, IRS recognized that problems existed with the withholding element of the TIN Penalty Program and said it has a cross-functional task force reviewing that issue. IRS noted that payor compliance with the withholding provisions is monitored as part of the package audit discussed in chapter 1. IRS acknowledged, however, that those audits “yield limited audit coverage of payors filing interest and dividend information returns.” It noted, therefore, that beginning with tax year 1986 returns, payors will be notified of any apparent liability for failure to withhold in cases involving missing TINs. Unless the payor has a certification or other evidence from the taxpayer that no TIN is needed, according to IRS, the payor will be required to remit any liability for withholding. IRS’ comments appear responsive to our recommendation.

In its comments, IRS also expressed the position that (1) third parties, like payors, are IRS’ partners in making the tax administration system work; (2) it is in the government’s interest to work with payors to

encourage long-term compliance with the rules surrounding information returns; and (3) penalties should not be a first resort in achieving compliance if a payor is “sincerely trying to comply and has instituted reasonable business practices to assure compliance.” IRS acknowledged, however, that penalties provide a necessary sanction for those who are otherwise “unwilling to establish adequate information reporting systems.”

So as to avoid implying that we think a penalty should be assessed in every situation, no matter what the circumstances, we have revised our recommendation to refer to IRS’ assessment of a penalty when appropriate.

IRS Can Provide Better and More Timely Information to Payors

As part of its 1985 TIN Penalty Program, IRS sent payors a list of 12.5 million accounts for which they had submitted interest and dividend information returns with missing or incorrect TINs. There are steps IRS can take internally to reduce the number of accounts included on such lists. Those steps involve (1) using available information to resolve "incorrect" TINs that are caused by the payees' use of different names on their bank or brokerage accounts that differ from those on Social Security or IRS files and (2) providing payors with more timely information on missing or incorrect TINs so that those TINs might be obtained or corrected before the next year's returns are submitted. IRS officials told us they planned to start taking those steps later this year.

IRS Can Reduce the Number of Incorrect TINs Returned to Payors

Under the TIN Penalty Program, payors are required to exercise due diligence in obtaining correct TINs from payees. There is no requirement that they obtain correct names. Yet, many of the "incorrect" TINs included on lists which IRS sends to payors are only considered incorrect because the names associated with those TINs on the information returns are not the same as the names associated with the same TINs on Social Security or IRS files. This might occur, for example, if a recently married woman opened a savings account under her married name but did not notify the Social Security Administration of her name change. Under current program procedures, such name mismatches are included on the lists of incorrect TINs sent to payors for which they have to certify as to due diligence. IRS has the capability, however, to resolve such mismatches without sending them to payors.

Many Incorrect TINs Result From Name Mismatches

Of the 405.6 million interest and dividend information returns received by IRS for tax year 1985, 23 million were considered to have incorrect TINs because they could not be validated. Of those returns, 17 percent (or 3.8 million) were considered incorrect even though the TIN on the return exactly matched the TIN on Social Security and IRS files. IRS considered these returns incorrect because the name on the return did not match the name on those files.

Our discussion with payors who had been contacted by IRS as part of the 1984 and 1985 TIN Penalty Programs confirmed that many incorrect TINs are the result of name mismatches. One payor who had been notified of 17,000 incorrect TINs, for example, determined, after contacting payees, that about 13,000 TINs were incorrect because the name on the information return did not match the name on Social Security or IRS files. We know of four other payors who did similar research and found that

many of the incorrect TINs resulted because payees had changed their names through marriage but had not notified the Social Security Administration or IRS. Payors told us, and we agree, that they should not be asked to serve as enforcement agents for resolving incorrect TINs resulting from circumstances beyond their control, such as name changes that were not provided to Social Security. They suggested that those problems should be resolved by IRS and the Social Security Administration.

IRS Has Information in Its Files That Can Be Used to Correct Name Mismatches

In September 1987, we talked to officials responsible for the TIN Penalty Program about steps that might be taken to enable IRS to resolve more incorrect TINs on interest and dividend information returns and thus reduce the number of incorrect TINs that are returned to payors. One of the possibilities mentioned was the use of two files (called the fact-of-filing and cross reference files) that IRS now uses to correct TINs on individual income tax returns. The fact-of-filing file contains entity data and historical filing information on primary filers. The cross reference file contains similar information on secondary filers.¹

In using these files to correct TINs on income tax returns, IRS matches the taxpayer's name, address, and TIN contained in the files against the same information recorded on the tax return. According to an IRS official, the complementary information in the two files assists in resolving incorrect TINs. If a single woman, for example, filed as a primary filer one year, a fact-of-filing record would be generated. If she subsequently married and filed a joint return, as a secondary filer, with her husband, a cross-reference record would be generated. IRS then has two sources to use in checking for a correct TIN.

We believe that IRS should use the fact-of-filing and cross reference files in an attempt to resolve incorrect TINs on information returns. By checking the list of incorrect TINs against the two files before generating the list of missing and incorrect TINs sent to payors, IRS would avoid having to send payors information on many TINs that are incorrect due to name mismatches and payors would avoid having to deal with those TINs. IRS estimates that if it had used these two files on tax year 1984 information returns, it would have reduced the number of accounts with incorrect TINs sent to payors from 12.8 million to 8.3 million.

¹On joint income tax returns, the first name that appears on the name line is the primary filer and the second name is the secondary filer.

After our September 1987 meeting, IRS further considered the feasibility of using the fact-of-filing and cross reference files. In January 1988, a TIN Penalty Program official told us that IRS had decided to use the two files to generate the list of incorrect and missing TINs on tax year 1986 information returns. That was done in June 1988. According to IRS' statistics, it attempted to resolve incorrect TINs on about 19 million tax year 1986 interest and dividend information returns and was successful in about 1.9 million cases, or 10 percent.

**IRS Could Provide
 More Timely
 Information on
 Missing and Incorrect
 TINs to Payors**

As shown in table 3.1, IRS' schedule for sending out lists of missing and incorrect TINs to payors does not allow payors sufficient time to correct their files before submitting the following year's information returns. For instance, payors submitted tax year 1984 information returns in February 1985 but IRS did not send out lists of incorrect or missing TINs until May 1986—3 months after the February 28, 1986, due date for tax year 1985 information returns.

**Table 3.1: TIN Penalty Program Schedule
 -1984 Through 1987**

Tax year	Date interest and dividend information returns due from payors	Date TIN penalty list sent to payors
1984	February 1985	May 1986
1985	February 1986	November 1986
1986	February 1987	July 1988 ^a
1987	February 1988	November 1988 ^a

^aThese dates reflect IRS program schedules as of February 1988.

Payors told us that to allow them time to correct their data before the February deadline for submitting interest and dividend information returns, they need IRS' information on missing and incorrect TINs by the preceding October. TIN Penalty Program officials told us there were delays in sending out lists of missing and incorrect TINs during the first 2 years of the program because of the time needed to develop procedures for implementing the new program. They said that the list for tax year 1986 returns is not scheduled to be sent to payors until July 1988 because IRS wanted to wait until regulations were issued instructing payors on withholding requirements in cases involving incorrect TINs. Although the regulations were issued in November 1987, an IRS official told us that the list cannot be sent out until July 1988 because computer and staff are being used to process 1987 income tax returns.

Starting with the tax year 1987 program, IRS officials told us that they expect to be able to send the list of missing and incorrect TINs to payors by November of the year in which the payors filed the information returns. They do not expect to be able to meet the October mailing preferred by payors because IRS will need the additional month to match the list of TINs against the fact-of-filing and cross reference files. Because this match should reduce the number of changes required by payors, however, IRS officials believe payors will have sufficient time to correct the TINs before the next year's filing. If the number of accounts included on the lists sent to payors is significantly reduced as a result of matching against the fact-of-filing and cross reference files, we believe a November mailing would be timely.

Conclusions

As part of the TIN Penalty Program, IRS sends payors lists of accounts with TINs that it has determined to be missing or incorrect. Because the requirement to deal with each of those accounts imposes an administrative burden on payors, it is important for IRS to do all it can, within reason, to ensure that those lists include only accounts warranting payor attention. In our opinion, that is not now the case.

Under current procedures, the lists sent to payors include accounts that are incorrect not because the TIN is wrong but because the name associated with the TIN on the payor's records does not match the name associated with the same TIN on Social Security or IRS files. IDTCA requires a payor to obtain a certified TIN; it does not require the payor to obtain a certified name. To the extent payors are being asked to resolve name mismatches they are being asked, in our opinion, to shoulder a responsibility that is not theirs. There is a way, using existing fact-of-filing and cross reference files, for IRS to identify name mismatches so that it can exclude them from the lists sent to payors. IRS officials told us that they plan to start using those files later this year.

Besides providing payors with more refined lists of accounts with missing or incorrect TINs, IRS should provide those lists in a more timely manner so payors can correct their data before preparing the next year's information returns. The sooner a payor can correct its data and begin submitting interest and dividend returns that have correct TINs, the sooner IRS can use those returns in its matching program, thus enhancing its opportunity to identify additional tax liabilities resulting from under-reported income. Enabling payors to correct TINs earlier should also reduce year-to-year duplication in IRS' efforts to resolve incorrect TINs. IRS officials told us they plan, beginning this year, to mail out the lists in

November, which they believe will give payors time to correct their data before the following year's information returns are due.

Because IRS plans to begin using the fact-of-filing and cross reference files and to mail out lists of missing and incorrect TINs sooner, we are not making any recommendations.

IRS Can Better Target Resources to Reduce Missing and Incorrect TINs on Information Returns

For tax year 1985, IRS received 28.4 million interest and dividend information returns with missing and incorrect TINs. As shown in table 4.1, the TINs on 16.8 million of these returns, representing payments of \$106.9 billion, could not be corrected through IRS' TIN perfection process and thus could not be matched against income reported on income tax returns. There is a manual procedure that IRS could use, however, to correct some of those TINs and thus make more returns usable in IRP. IRS has successfully tested the use of that procedure, called Key Index File research, on interest and dividend returns with missing TINs. We believe IRS, with a minimal increase in resources, could expand that effort to interest and dividend returns with incorrect TINs if it focused on large dollar returns.

Table 4.1: Missing and Incorrect TINs for Tax Year 1985 Not Corrected Through TIN Perfection^a

Dollars in billions			
	Number	Percent	Interest and dividend payments
Missing TINs not corrected	3,974,053	23.6	\$10.3
Incorrect TINs not corrected	12,849,296	76.4	96.6
Totals	16,823,349	100.0	\$106.9

^aIRS extracted this data from its Information Returns Master File and Unperfected Information Returns File.

IRS Tested the Use of Manual Research on Some Interest and Dividend Returns

Manual research involves employees at IRS' 10 service centers manually comparing the street address, zip code, name, and TIN (if available) reported on an information return with the same information contained on IRS' individual and business master files. Because manual research occurs in November, about 2 months after TIN perfection, more current information is available in the master files, which may cause information to match that could not be matched earlier. If the information matches, the TIN is considered correct. If the information does not match, a notice is sent to the payee requesting the correct TIN.

Manual Research on Miscellaneous Information Returns Has Had Good Results

In 1986, the first year IRS used the manual process, IRS researched tax year 1985 information returns that reported miscellaneous income, such as rents and royalties, of over \$10,000 and that included incorrect TINs. A TIN Penalty Program official told us that IRS focused its research on those returns because of limited service center resources and the high potential for additional taxes if underreporting were identified.

Of 266,755 miscellaneous income information returns that were sent to the service centers for research, IRS was able to correct the TINs on 164,601 (62 percent) either by matching information contained in its master files or through mail contacts with the payees. The remaining 102,154 returns (38 percent) could not be corrected through service center research.

IRS' Test of Manual Research on Interest and Dividend Information Returns Produced Good Results

IRS' Austin Service Center recently tested use of the Key Index File on interest and dividend information returns. The test, which ended in December 1987, involved 269,315 tax year 1986 information returns with missing TINs. Initially, IRS planned to send returns to each of the 10 service centers but because there were not enough personnel to conduct the labor intensive research at each center, IRS decided to use Austin as a single test site. The test showed that Austin, using manual research, was able to obtain TINs on 93,890 (or 35 percent) of the returns.

A TIN Penalty Program official told us that Austin focused on returns with missing TINs because IRS anticipates developing an automated system to resolve incorrect TINs. IRS officials told us that plans to develop this system are in their earliest stages, and the system will not be in operation for a couple of years.

IRS Can Use Manual Research to Resolve Incorrect TINs by Focusing on High Yield Cases

As shown in table 4.1, of the 16.8 million interest and dividend information returns with TINs that could not be resolved through TIN perfection, most (about 12.8 million) involved incorrect TINs. However, until the Automated TIN Correction System becomes operational, which will not be for a couple of years, IRS will have no program to correct such TINs.

IRS may not have enough staff to manually research all returns with incorrect TINs. IRS could limit its staff needs, however, by concentrating on those returns with the greatest potential for additional taxes. For example, our analysis of IRS' tax year 1985 data showed that returns with incorrect TINs reporting payments over \$100,000 represented less than 1 percent of the returns but accounted for 83 percent of the total interest and dividend payments. We identified 54,229 of these returns reporting \$80.6 billion in payments.¹

¹The \$100,000 threshold is only being used as an example. Because IRS does not have a matching program for business information returns and because many of the returns involving interest and dividend payments of over \$100,000 probably involve business payees, a threshold of less than \$100,000 might be more appropriate.

Conclusions

A purpose of the TIN Penalty Program is to notify payors of missing or incorrect TINs so they can obtain correct TINs for use on subsequent years' interest and dividend information returns, thus making those returns usable in the IRP matching process. IRS now does nothing after TIN perfection to try to make the current year's return usable. There is a procedure, however, that IRS could use beyond TIN perfection—a procedure that involves a manual search of IRS' files and correspondence with the payee. IRS recently tested that procedure on interest and dividend returns with missing TINs. Assuming IRS' assessment of the test results indicates that expansion of manual research would be cost effective, we believe it should consider including incorrect as well as missing TINs in that expansion. Excluding incorrect TINs, which account for most of the unperfected TINs, in anticipation of a computer system that is several years away, limits IRS' opportunity to enhance IRP effectiveness. The impact of including incorrect TINs on IRS staff could be minimized by focusing on returns with the greatest yield potential.

Recommendation to the Commissioner of Internal Revenue

If IRS, after assessing its test results, decides to use the Key Index File on interest and dividend information returns with missing TINs, we recommend that it consider expanding that use to returns with incorrect TINs until the automated TIN correction system is implemented. To best use its limited staff, IRS should focus on returns that have the highest potential to yield additional taxes.

Agency Comments and Our Evaluation

In commenting on a draft of this report, IRS agreed that use of the Key Index File should be explored, but that it should only be used if cost effective. We agree that cost effectiveness is a valid determinant. Thus our suggestion that IRS focus on returns that have the highest yield potential.

Financial Institutions and Trade Associations Contacted During GAO's Review

Banking Industry	
Payor	Location
Bangor Savings Bank	Maine
Barclays Bank of California	California
California National Bank	California
The Central Trust Company, N.A.	Ohio
East Rivers Savings Bank	New York
Fifth Third Bank	Ohio
First American Bank, N.A.	Washington, D.C.
The Riggs National Bank of Washington D.C.	Washington, D.C.
Sag Harbor Savings Bank	New York
Bank of San Francisco	California
Trans Pacific National Bank	California
Wachovia Bank and Trust Company, N.A.	North Carolina
Wells Fargo and Company	California
Savings and Loan Industry	
Charter Oaks Savings Association	Ohio
Gateway Federal Savings and Loan Association	Ohio
Home Federal Savings and Loan Association	Washington, D.C.
Howard Savings Bank	New Jersey
Hunter Savings Association	Ohio
North Cincinnati Loan & Building Company	Ohio
Washington Federal Savings and Loan Association	Washington, D.C.
Credit Union Industry	
Norwood Federal Credit Union	Ohio
G.E. Evendale Federal Credit Union	Ohio
Golden Gate Federal Credit Union	California
South Oakland County Credit Union	Michigan
California State Automobile Association Employees Federal Credit Union	California
Securities Industry	
Gradison Financial Services	Ohio
Merrill Lynch, Pierce, Fenner and Smith, Inc.	New York
Prudential-Bache Securities	New York
E.F. Hutton and Company, Inc.	New York

(continued)

**Appendix I
Financial Institutions and Trade Associations
Contacted During GAO's Review**

Banking Industry	
Payor	Location
Life Insurance Industry	
Aetna Life and Casualty Company	Connecticut
New York Life Insurance Company	New York
Ohio National Life Insurance Company	Ohio
State Farm Insurance Companies	Ohio
Western Southern Life Insurance Company	Ohio
Trade Associations	
American Bankers Association	Washington, D.C.
American Council of Life Insurance	Washington, D.C.
Credit Union National Association	Washington, D.C.
National Council of Savings Institutions	Washington, D.C.
Securities Industry Association	Washington, D.C.

**Appendix I
Financial Institutions and Trade Associations
Contacted During GAO's Review**

Comments From the Internal Revenue Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

JUN 15 1988

Mr. Richard L. Fogel
Assistant Comptroller General
United States General Accounting Office
Washington, D.C. 29548

Dear Mr. Fogel:

Thank you for the opportunity to comment on your draft report entitled "Tax Administration: Opportunities to Improve the Accuracy of Taxpayer Identification Numbers (TINs) on Information Returns".

Overall, we agree with the report's recommendations and general conclusions. We have recognized particular problems with the back-up withholding element of the TIN Penalty Program and currently have a cross-functional task force reviewing all facets of that program. In our attached comments, however, we do take exception with the GAO estimate of the \$2.3 billion amount which should have been withheld for Tax Year 1985, as well as any inference that such an amount reflects a similar amount of revenue loss.

The IRS is also conducting a comprehensive review of the civil penalty structure in the Internal Revenue Code. Information returns penalties are a subpart of that study. The preliminary study report differentiates information return penalties from other tax penalties by pointing out that the information return system relies largely on the furnishing of accurate information by third parties. These third parties become partners of the IRS in making the tax administration system work. Accordingly, it is in the interest of the government to work with payors to encourage long-term compliance with these rules.

In this context, penalties should not be a mechanism of first resort in achieving compliance if a payor is sincerely trying to comply and has instituted reasonable business practices to assure compliance. Penalties, however, are still an essential fixture to provide a necessary sanction for those who are otherwise unwilling to establish adequate information reporting systems. Later this year, we should be releasing recommendations which will be aimed at more effectively administering penalties and encouraging compliance in this area, as well as others.

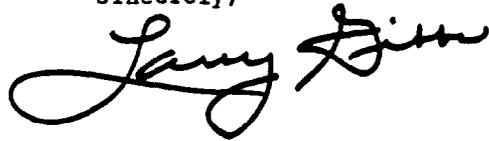
Appendix II
Comments From the Internal Revenue Service

-2-

We have enclosed detailed comments on the report recommendations. We hope you find these comments useful.

With kind regards,

Sincerely,

A handwritten signature in cursive script, appearing to read "Larry Simon". The signature is written in black ink and is positioned to the right of the typed name "Larry Simon".

Enclosure

TAX ADMINISTRATION: OPPORTUNITIES TO IMPROVE
THE ACCURACY OF TAXPAYER IDENTIFICATION NUMBERS (TINS)
ON INFORMATION RETURNS

RECOMMENDATION 1:

IRS should establish procedures to (1) determine whether payors are complying with the withholding requirements on interest and dividend information returns, and (2) enforce the penalty associated with failure to withhold on such returns.

Comment:

Compliance by payors with the withholding provisions is monitored through our package audit procedures as part of our income tax and employment tax examinations. As noted in the report, this yields limited audit coverage of the payors filing interest and dividend information returns.

Beginning with Tax Year 1986 information returns, however, the IRS will notify payors of any apparent liability for failure to withhold for missing TINs on interest and dividend information returns. Unless the payor has a certification or other evidence from the taxpayer that no TIN is required for that return, the payor must remit any liability for back-up withholding on Form 941C, "Statement of Correct Information Previously Reported on the Employer's Federal Tax Return".

RECOMMENDATION 2:

If IRS, after assessing its test results, decides to use manual research procedures on interest and dividend returns with missing TINs, GAO recommends that it consider expanding that use to returns with incorrect TINs and focus on returns with the highest potential to yield additional taxes.

Comment:

This second recommendation in the report suggests that IRS consider expanding the use of the Key Index File which relies on manual research to reconcile incorrect TINs on information returns. This manual procedure would be utilized until the automated TIN correction system is implemented. IRS agrees that use of the Key Index File and additional manual research should be explored. However, as the report notes, this file should be used only if it is cost effective. We have not yet determined whether it would be cost effective to extend it to all types of information returns nationwide.

FINDINGS

We have the following comments on several of the findings in the report.

Missing TINs

The report states that for Tax Year 1985, there were an estimated 1.46 million information returns that had no TIN and that the amount of withholding should have been \$2.3 billion. We cannot agree with this estimate for several reasons. Many of those TINs are missing for a variety of legitimate reasons. For example, TINs are not required for non-resident aliens, exempt organizations, certain trusts and for most corporations. To the extent these information returns are included in GAO's sample, the total universe of information returns with no TINs which are truly subject to back-up withholding would be lower.

See comment 1.

In addition, if payors are pursued by IRS as failing to withhold because there was no TIN with the information return, the maximum amount IRS believes it could collect from the payor is 20% of any payment over \$10 annually. GAO seems to assume that we could collect an amount above that by collecting the tax and a penalty of 100 percent in certain cases. We do not agree that Internal Revenue Code section 6672, which is the basis for the 100 percent penalty, applies in the case of back-up withholding.

See comment 2.

Finally, our TCMP data suggests that taxpayers voluntarily report a high percentage of their interest and dividend income. Consequently, the absence of back-up withholding in these areas does not necessarily equate to dollar-for-dollar noncompliance and revenue losses.

Incorrect TINs

With respect to back-up withholding for incorrect TINs, we note that GAO estimates the number of incorrect TINs to be as high as 23 million for Tax Year 1985. However, this number simply represents the potential universe. Payors, upon notification of incorrect TINs are very likely to obtain a new certification of the correct TIN rather than institute back-up withholding. The GAO report confirms this with the illustration of the payor who found that 13,000 out of 17,000 TINs on the list of mismatches supplied by the IRS would not have been subject to back-up withholding because their names had changed, but their numbers were correct. Thus, we believe that the actual number of incorrect TINs and, therefore, the amount of back-up withholding, is much smaller.

The following are GAO's comments on the Internal Revenue Service's letter dated June 15, 1988.

GAO Comments

1. These numbers have since changed to 2.8 million and \$2.4 billion, respectively.
2. This comment relates to information no longer in the report.

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