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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT  
DIVISION

FEBRUARY 11, 1980

B-197350

The Honorable Jerome Kurtz  
Commissioner of Internal Revenue <sup>4</sup>  
Department of the Treasury

Dear Mr. Kurtz:

Subject: IRS Efforts To Detect and Pursue Corporate  
Nonfilers (GGD-80-34)

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Our review of the Internal Revenue Service's (IRS') efforts to deal with corporations failing to file required income tax returns (Form 1120) focused primarily on IRS' Taxpayer Delinquency Investigation Program. Overall the program has been effective in detecting and pursuing corporate nonfilers.

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This review was a follow-on to our review of IRS' individual nonfiler efforts, which was discussed in our July 11, 1979, report to the Congress entitled "Who's Not Filing Income Tax Returns? IRS Needs Better Ways To Find Them and Collect Their Taxes." We evaluated the corporate nonfilers program at IRS district offices in Brooklyn, Cincinnati, and Salt Lake City. We also did work at IRS headquarters in Washington, D.C., and IRS service centers in Brookhaven, New York; Covington, Kentucky; and Ogden, Utah.

Generally, the weaknesses we did find in IRS' investigative policies and procedures for securing delinquent corporate income tax returns are similar to those discussed in chapter 3 of our individual nonfilers report. Therefore, IRS' implementation of the recommendations in that report should result in similiar improvements to its corporate nonfiler efforts. However, some further opportunities exist for improving the corporate efforts.

While IRS is generally successful in securing returns from corporations who owe taxes, it could do more to locate and secure returns from corporations who claim they owe no taxes. Thoroughly investigating corporate nonfilers may

not be as cost effective as it is for individual nonfilers. Because many delinquent corporations either are no longer in business or have suffered losses, they are less likely to owe taxes. At a minimum, however, IRS could, at little or no additional cost, check telephone and city directories and use State data to locate delinquent corporations.

Furthermore, to enhance compliance and verify tax liabilities, IRS should secure all income tax returns from corporations which it locates even when they claim they owe no taxes. Without securing these nontaxable returns, IRS cannot determine whether corporations' claims of no tax liability are accurate. In addition, when full compliance with the law is not obtained or encouraged, subsequent delinquencies could occur by the same corporations, thereby increasing the workload and costs of the Taxpayer Delinquency Investigation Program.

Our review of 268 randomly selected delinquent corporation cases in the geographic areas covered by 3 district offices showed that IRS secured returns in 72 cases. Eight of the 72 had tax liabilities of about \$66,000 in taxes, while the other 64 corporations owed no taxes. Of the remaining 196 cases, IRS closed 90 cases, or 46 percent, because it could not locate the corporations; and 106 cases, or 54 percent, because the corporations were not required to file.

To determine if more thorough investigations would increase compliance among the delinquent corporations, we had IRS investigate 52 of the 90 cases which it had previously closed as "unable to locate." IRS located 40 corporations. Of these, 6 were still in business and 14 delinquent returns were secured from 4 of them. Although the remaining corporations were no longer in business, IRS did secure five returns from three corporations.

When IRS closes cases as unable-to-locate, this action deletes the corporations' filing requirement from the IRS master file. As a result, IRS will no longer pursue these corporations even if they are still in business.

Six of the 40 corporations IRS investigated for us and located after the cases were closed as unable-to-locate were still in business. Two of the six corporations were located

through the telephone directory, while another two corporations were found on the basis of information on file with the State agency which maintains data on corporations doing business in the State.

State data on corporations and city and telephone directories are readily available sources to use to locate delinquent corporations. IRS procedures, however, do not require that these sources be used in all cases. Because of the easy availability and usefulness of these sources, as well as the limited effort required to use them, IRS should require that these sources be checked on all corporate non-filer cases. The possible benefits to be gained by checking these sources should outweigh the cost involved in having an IRS employee check the telephone directory or State data to determine if the subject corporation is listed.

Of the 106 cases IRS had previously closed as "not required to file," it did not secure tax returns in 31 cases, or about 19 percent, even though the corporations were still in business. In 24 of the 31 cases, when the corporations were contacted by IRS, they claimed they owed no taxes. The other seven cases were closed because IRS procedures allow cases to be closed as not required to file if further investigation would be costly or no net taxes are due.

Not securing tax returns, particularly when corporations are located and no additional investigative work and costs are required, poses several tax administration problems. First, IRS has no proof, other than a corporate official's word, that a loss was suffered. Second, IRS has no opportunity, through its examination process, to verify the accuracy of a corporation's claim. Third, the corporations may be encouraged not to comply with the tax laws. Noncompliance in turn leads to increased workload and costs under the Taxpayer Delinquency Investigation Program in subsequent years if the corporations continue to be delinquent and thus subject to IRS investigation.

Once IRS contacts corporations, it should secure delinquent returns regardless of whether taxes are owed. This will not only foster compliance and give IRS the means to verify taxpayer claims but could also reduce investigative workloads in the future.

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Accordingly, we believe that you should require all corporate nonfiler cases be subjected to a search of local city and telephone directories and State agency records on corporations doing business in the State before the cases are closed as unable-to-locate. You should also require all delinquent income tax returns be secured once the corporations have been contacted.

We appreciate the assistance provided us by your staff. Please call me if you have any comments or questions on this matter.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "A. Voss", is written over the typed name.

Allen R. Voss  
Director