TAX GAP

IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements

What GAO Found

The Internal Revenue Service (IRS) does not know to what extent payers fail to submit required 1099-MISCs, but various sources point to the possibility of a significant problem. For tax year 2005, 8 percent of the approximately 50 million small businesses with assets under $10 million submitted 1099-MISCs, but IRS does not know how many of the other 92 percent were required to report payments but did not. Many business payments, such as payments to corporations, are not subject to 1099-MISC reporting. If even a small share of the businesses that did not submit a 1099-MISC should have, millions of 1099-MISCs could be missing with significant amounts of unpaid taxes by payees. GAO’s prior work in 2003 found significant 1099-MISC payer noncompliance by some federal agencies. IRS could mitigate costs for research on payer noncompliance by building on its existing research programs.

Number of Small Businesses Submitting 1099-MISCs, Tax Years 2002 to 2005

Payers face a variety of impediments that may contribute to 1099-MISC noncompliance, including complex reporting requirements and an inconvenient submission process. For example, certain payments to unincorporated persons or businesses are subject to 1099-MISC reporting, but payments to corporations generally are not, requiring payers to determine the status of their payees. GAO in the past determined that the benefits in terms of increased tax revenue and improved taxpayer compliance justify eliminating this distinction. IRS agrees, and the Bush Administration’s proposal to do so would have required legislative action. Other options to remind payers about their reporting obligations include adding a tax return checkbox asking if payers submitted required 1099-MISCs and adding a chart to help payers navigate the detailed instructions for the Form 1099-MISC.

IRS matches what the payees report on their tax returns to what payers report on 1099-MISCs to detect payees underreporting income and taxes. But IRS does not pursue all mismatches its computers detect. If IRS were to increase payer compliance with 1099-MISC requirements, the number of mismatches would likely increase. However, IRS does not systematically collect information on the causes of mismatches or whether they could be prevented.