SMALL BUSINESSES

IRS Considers Taxpayer Burden in Tax Administration, but Needs a Plan to Evaluate the Use of Payment Card Information for Compliance Efforts

Why GAO Did This Study

A challenge IRS faces is balancing efforts to minimize taxpayer burden with efforts to ensure compliance with the tax code. Small businesses are a vital source of economic growth in the United States. Reducing their costs for complying with the tax code may free up resources to expand, hire new employees, and contribute to the growth of the U.S. economy. GAO was asked to examine small business tax compliance burden and IRS’s payment card pilot that addresses taxpayer non-compliance. This report: (1) describes characteristics of the small business population (2) describes how characteristics of a small business affect compliance burden; (3) describes how IRS integrates small business compliance burden considerations in decision-making; and (4) assesses IRS’s plan for evaluating its payment card pilot. To answer these objectives, GAO analyzed Treasury and IRS data, research, and other documentation and interviewed agency officials. GAO used its guidance on program design evaluation to assess IRS’s payment card pilot evaluation plan.

What GAO Found

According to estimates produced by government tax researchers using 2010 taxpayer data, small businesses (defined in the research as individuals or entities with substantive business activity but with less than $10 million in total income and deductions) make up 99 percent of all businesses. Approximately 69 percent of small businesses (about 16 million) are individual taxpayers who report business income and the remaining 31 percent (or roughly 7.3 million) are partnerships or corporations. Small businesses with at least one employee make up about 20 percent of the small business population, but produce about 71 percent of total small business income.

Small businesses undertake a number of tax compliance-related activities that create burden. These activities can be grouped into general categories such as income tax activities, employer-related tax activities, and third-party information reporting activities. The tax compliance burden associated with these activities varies depending on the businesses’ asset size, filing entity type (e.g., sole proprietor, partnership), number of employees, and industry type. According to IRS research, compliance burden increases with the size of businesses, whether measured in terms of assets, receipts, or employment. IRS also measured money and time burden as a portion of total business receipts, total assets, and burden per employee. Across all three measures, IRS results were consistent with the assumption that small businesses face significant fixed compliance costs combined with decreasing marginal costs as the business grows.

IRS’s decision-making framework for administering the tax system includes consideration of small business compliance burden. For example, IRS’s strategic plan identifies reducing taxpayer burden as a strategic goal. IRS provided examples of how it works with internal and external stakeholders to reduce taxpayer burden on small businesses. For example, IRS collaborated with Treasury and external stakeholders to develop a simplified method for some small businesses to calculate a home office deduction, which was introduced in January 2013. Previously, businesses had to complete a complex property depreciation calculation.

To improve tax compliance among small businesses, in 2012, IRS began piloting a program that compares payment data from payment settlement entities (such as credit card companies) with income reported by small businesses. IRS is testing ways to use payment data to detect underreporting of taxable income while minimizing small business taxpayer burden. While IRS’s plans for evaluating the pilot include many key evaluation elements that GAO identified, other elements are missing. For example, IRS has defined high level pilot goals such as improving voluntary compliance and reducing the tax gap, but has not established measures for determining progress against these goals. Additionally, the plan did not adequately document evaluative questions, data collection needs, or the evaluative criteria necessary to assess whether pilot activities produced the intended results. Without these and other elements, IRS cannot ensure it is making evidence-based decisions about expanding and integrating pilot activities into broader small business compliance improvement efforts.

What GAO Recommends

To improve the evaluation of the payment card pilot, GAO recommends that IRS clearly define the stages of the pilot and establish measurable goals for determining when the pilot progresses from one stage to the next and develop an evaluation plan for the overall pilot that includes evaluation questions, complete descriptions of needed data, and evaluation criteria. IRS agreed to take the recommended actions.

View GAO-15-513. For more information, contact James R. McTigue, Jr. at (202) 512-9110 or McTiguej@gao.gov