

Why GAO Did This Study

The Internal Revenue Service (IRS) does not know how many businesses failed to file required returns, nor does it have an estimate of the associated lost tax revenue—the business nonfiling tax gap. Many cases it does investigate are unproductive because the business does not owe the return IRS expects. GAO was asked to assess (1) the data challenges of estimating the business nonfiler tax gap, (2) how recent program changes have affected IRS's capacity to identify and pursue business nonfilers, and (3) additional opportunities for IRS to use third-party data. GAO reviewed IRS's tax gap estimates, nonfiler program processes and procedures, and matched closed nonfiler cases with various other data.

What GAO Recommends

GAO recommends that the Commissioner of Internal Revenue develop a partial business nonfiler rate estimate; set a deadline for developing performance data; develop a plan for evaluating the selection codes; reinforce the need to use income data and selection codes in verifying taxpayer statements; and study the feasibility and cost-effectiveness of using non-IRS data to verify taxpayer statements.

In written comments on a draft of this report IRS agreed that identifying and pursuing active business nonfilers is key to enforcement efforts and acknowledged that our recommendations could assist these efforts. IRS agreed with four of GAO's recommendations and indicated some steps it would take to address the other four.

[View GAO-10-950 or key components.](#)

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TAX GAP

IRS Has Modernized Its Business Nonfiler Program but Could Benefit from More Evaluation and Use of Third-Party Data

What GAO Found

IRS cannot develop a comprehensive estimate of the business nonfiling rate and associated tax gap because it lacks data about the population of all businesses. However, IRS could develop a partial estimate using its business nonfiler inventory. IRS identifies several million potential business nonfilers each year, more than it can thoroughly investigate. IRS could take a random sample of its inventory, thoroughly investigate those cases, and use the results to estimate the proportion of actual nonfilers in its inventory of potential nonfilers.

Until recently IRS has not had a way to prioritize cases in its large inventory. IRS modernized its business nonfiler program in 2009 by incorporating income and other data in its records indicating business activity. Active businesses generally have an obligation to file a return. IRS's Business Master File Case Creation Nonfiler Identification Process (BMF CCNIP) now assigns each case a code based on this data. IRS uses the code to select cases to work with the goal of securing tax returns from nonfilers and collecting additional revenue.

This is a significant modernization, but IRS lacks a formal plan to evaluate how well the codes are working. IRS has performance information on its individual nonfiler program but less on its business nonfiler program. Key management reports needed to provide program data are under development but no deadline has been set. IRS could also use more information on why many nonfiler cases are unproductive. This could potentially lead IRS to identify actions that could reduce IRS resources used on these cases and associated taxpayer burden.

GAO identified several opportunities including the following to enhance IRS's identification and pursuit of business nonfilers.

- The new BMF CCNIP selection codes provide a quick way to verify taxpayer statements that a business has ceased operations and does not need to file a return. Collections staff have been instructed to use the codes when making case closure decisions. They were previously instructed to use other income data but GAO's analysis indicated this may not have been done in all cases.
- Non-IRS data on businesses including federal contractors could be used to verify taxpayer statements about whether a tax return should have been filed. GAO's analysis of cases in two states that were closed as not liable to file a return found 7,688 businesses where non-IRS data showed business activity as measured by sales totaling \$4.1 billion. GAO also found cases closed as not liable to file a return involving 13,852 businesses on the federal contractor registry. GAO's analyses illustrated the potential value of non-IRS data but GAO did not assess which non-IRS data would be most useful nor examine the capacity of IRS's systems to use such data on a large scale.