GAO Highlights
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Highlights of GAO-11-218T, a testimony before the Committee on Small Business and Entrepreneurship, U.S. Senate

November 18, 2010

SMALL BUSINESSES

Tax Compliance Benefits and Opportunities to Mitigate Costs on Third Parties of Miscellaneous Income Reporting Requirements

Why GAO Did This Study

Third parties, often businesses, reported more than $6 trillion in miscellaneous income payments to the Internal Revenue Service (IRS) in tax year 2006 on Form 1099-MISC. Payees are to report this income on their tax returns. It has been long known that if these payments are not reported on 1099-MISCs, it is less likely that they will be reported on payee tax returns. In 2010, the reporting requirements were expanded to cover payments for goods and payments to corporations, both previously exempt, beginning in 2012.

This testimony summarizes recent GAO reports and provides information on (1) benefits of the current requirements in terms of improved compliance by taxpayers and reduced taxpayer recordkeeping, (2) costs to the third-party businesses of the current 1099-MISC reporting requirement, and (3) options for mitigating the reporting burden for third-party businesses. GAO has not assessed the expansion of 1099-MISC reporting to payments for goods.

What GAO Recommends

GAO is not making new recommendations in this testimony. In 2009, GAO suggested that Congress consider requiring payers to report service payments to corporations. GAO did not study reporting of payments for goods. Other prior GAO recommendations included ways for IRS to improve its use of 1099-MISC information received. IRS agreed with six of eight recommendations and is taking action to address them.

View GAO-11-218T or key components.
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What GAO Found

Information reporting is a powerful tool for encouraging voluntary compliance by payees and helping IRS detect underreported income. Also, information reporting may sometimes reduce taxpayers' costs of preparing their tax returns, although by how much is not known. IRS estimated that $68 billion of the annual $345 billion gross tax gap for 2001, the most current available estimate, was caused by sole proprietors underreporting their net business income. A key reason for this noncompliance was that sole proprietors were not subject to tax withholding and only a portion of their net business income was reported to IRS by third parties. The benefits from information reporting are affected by payers' compliance with reporting requirements and IRS's ability to use the information in its process that matches third-party data with tax returns. However, IRS does not have estimates of the number or characteristics of payers that fail to submit 1099-MISCs as required. To improve its use of 1099-MISC information, IRS has collected data to help identify ways to refine its matching process and select the most productive cases for review, as GAO recommended in 2009.

Current 1099-MISC requirements impose costs on the third parties required to file them. The magnitude of these costs is not easily estimated because payers generally do not track these costs separate from other accounting costs. In nongeneralizable case studies conducted in 2007 with four payers and five vendors that file information returns on behalf of their clients, GAO was told that existing information return costs were relatively low. One small business employing under five people told GAO of possibly spending 3 to 5 hours per year filing Form 1099 information returns manually, using an accounting package to gather the information. Two vendors reported prices for preparing and filing Forms 1099 of about $10 per form for 5 forms to about $2 per form for 100 forms, with one charging about $0.80 per form for 100,000 forms. However, these prices did not include clients' recordkeeping costs. Payers face a variety of impediments preparing and submitting 1099-MISC forms, including complex rules and an inconvenient submission process. For example, payers must determine whether payees are incorporated, must get the payees' taxpayer identification number, and must use special forms if filing on paper.

A variety of options exist for mitigating the costs of filing Form 1099-MISC. Most have pros and cons. IRS has already exempted payments, including those paid by credit card, which will be reported to IRS by other means. Other options include improving IRS guidance and education; adding a check-the-box question to business tax forms that would force return preparers to ask their clients whether they have complied with 1099-MISC reporting requirements; waiving late submission penalties for first-time payers; raising the payment reporting threshold; initially limiting the types of payments covered; having IRS develop an online filing capability; and allowing paper filers to submit computer-generated black and white 1099-MISCs rather than IRS's printed forms.